Outlook for Australian Property Markets 2010-2012

Brisbane

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Outlook for Australian Property Markets 2010-2012

Brisbane Residential

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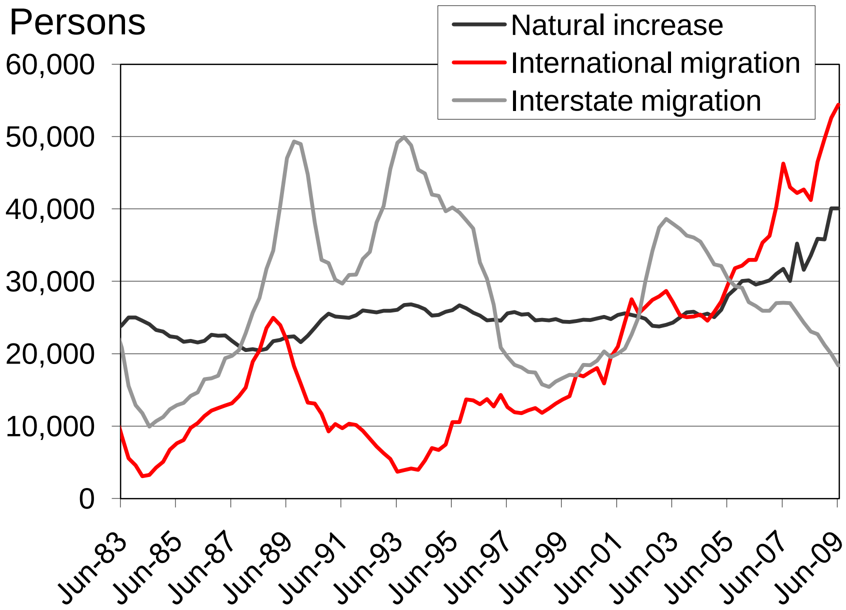
International migration continued to surge, despite global recession

Population growth – yearly rolling total



Source: ABS

- Queensland's population growth continued to set new records through the global recession. A total of 113,000 net growth in the year to June was the highest on record. At a growth rate of 2.6% it was above average, but not as high as in the 1980s.
- The driving factor for population growth remained international migration, something we believed last year would be impacted by the global recession. However, between June 2008 and June 2009 record net growth of 54,410 people moved to Queensland.
- The trend of fewer interstate migrants continued, yet while the net growth of 18,400 people had not hit the lows of the late 1990s or mid 1980s, the quarterly trend continued downwards in Q2 2009.
- However, the mini baby boom continues with natural increase surging through the year, although part of this will also be due to people living longer.

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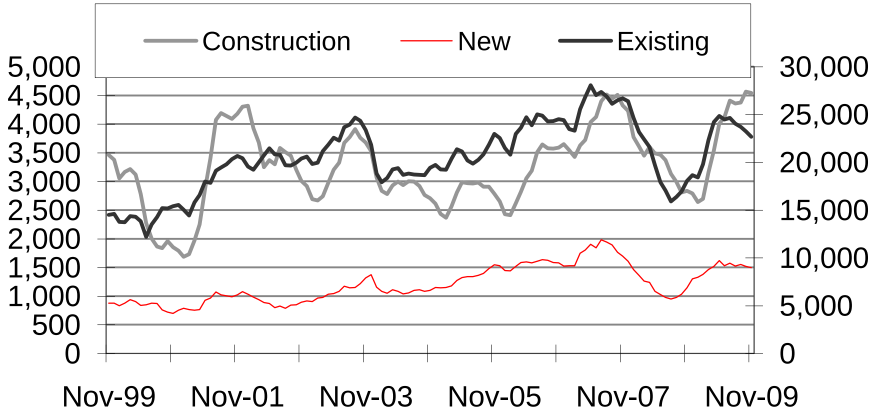
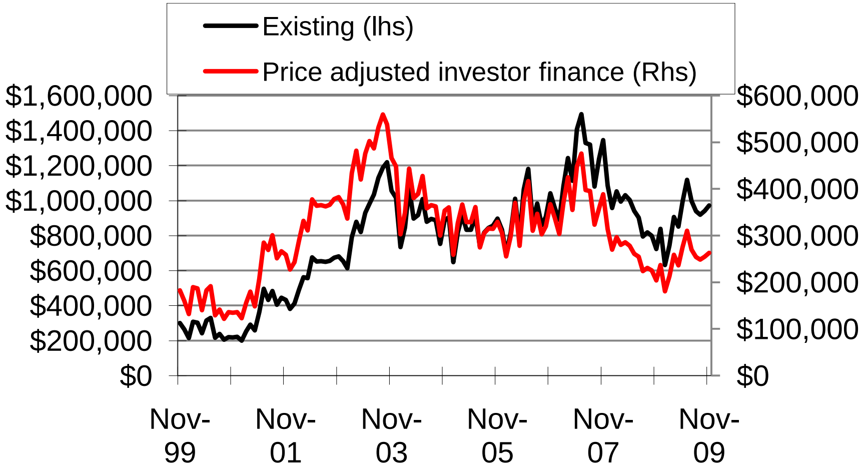
Construction lending booms, but overall recovery evident

Finance commitments for owner occupiers and investors - 3MMT





Source: ABS, REIA
Analysis: Westpac Property

- The impact of both fiscal and monetary stimulus, plus the positive surge in sentiment in 2H 2009 is clear in the residential market.
- Following plummeting demand in 2008, the higher boost from October 2008 for first home buyers (FHB) to purchase or build a new home is quite evident. Owner occupier finance to construct was up 73% in 2009 and finance to purchase a new dwelling up 66% between October 2008 and June 2009, but has stabilised in the latter since June.
- Finance to buy existing dwellings has also risen from the lows of mid 2008, up 56% between August 2008 and May 2009. Since then commitments have slowed.
- Investor finance has also shifted upwards, at a faster rate than owner occupiers, rising at over 70% in 1H 2009. However, such was the dearth of investors in 2H 2008 that investor activity has only returned to the 5 year average levels.

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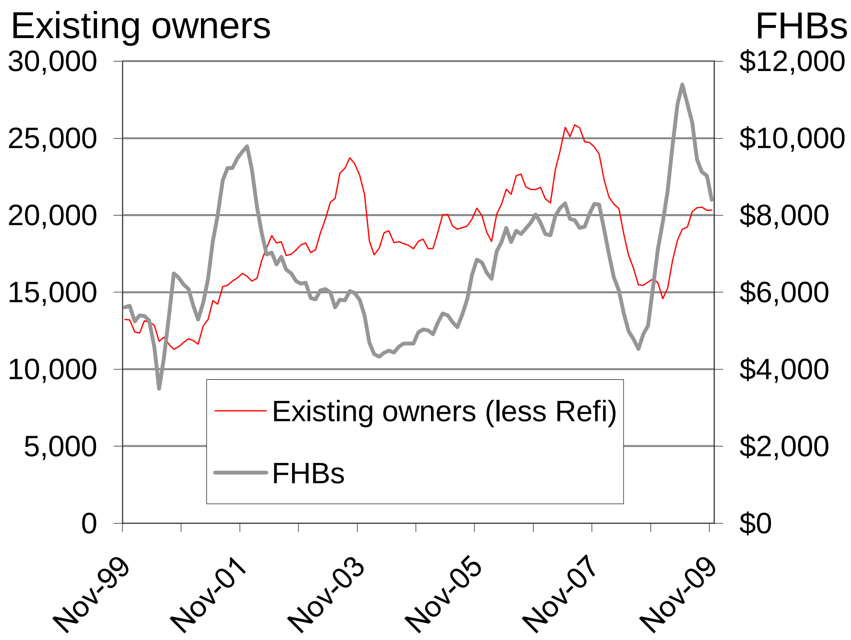
First home buyers fall as expected, while up-graders are increasing

First homes buyers tumble - Qld
3 monthly moving totals



- As expected, a combination of the wind back of the First Home Buyers (FHB) boost from September and the exhaustion of the potential numbers of FHBs, has led to FHBs tumbling in the final months of 2009.
- Following a surge of 138% from the lows of August 2008, the number of FHBs fell by 26%, or 2,993 people, in the six months to November 2009. We expect continued declines into 2010, although at a slower rate.
- However, as confidence in the economy improved, a number of existing owner occupiers returned to the market.
- Although the existing owner occupiers are a far greater group, the lift in numbers has not yet helped off-set the slowdown in FHBs in QLD. The number of existing owner occupiers upgrading rose by some 6.5% or 1,240 people over the same period that FHBs fell.
- With expectations of continued improvement in the economy and recent price gains, Westpac Property expect demand from this sector will continue to rise in 2010, despite further interest rate hikes.

Source: ABS; REIA
Analysis: Westpac Property

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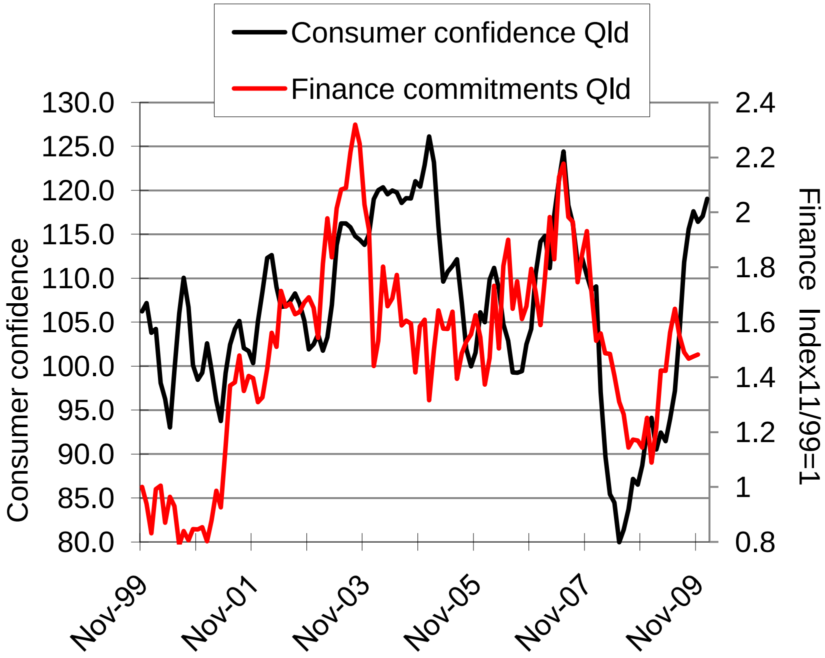
Continued positive confidence to outweigh interest rate rises

Strong confidence levels suggest continued activity



Source: ABS, REIA
Analysis: Westpac Property

- In forecasting future market activity in the QLD residential market, a number of factors are important; interest rates, employment, affordability, level of supply and confidence. While all contribute to activity, full-time employment has the strongest correlation, just above confidence.
- Although employment has a stronger correlation, the story of 2009 was consumer confidence, which surged from the middle of 2009 and fed through to an improving residential market. Of course, 50-year low mortgage rates would have helped.
- Expectations of improved employment prospects should keep consumer confidence in positive territory for 2010 (above 100) and allow an active market.
- The potential dampener are rising interest rates. Over 2010 WBC Economics are forecasting that the cash rate will rise to 4.50% by mid 2010, from 3.75% at the start of the year. This would push the mortgage rate to around 7.40%, which is around average. With confidence likely to stay positive, an active but not overactive market should result.

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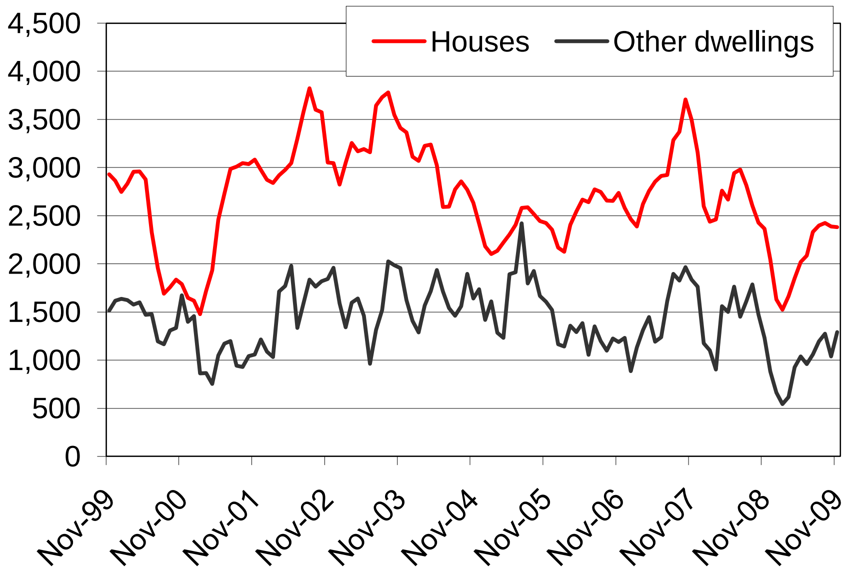
Under supply intensifying as approvals for year fall further

Dwelling approvals – Brisbane
3 monthly moving totals

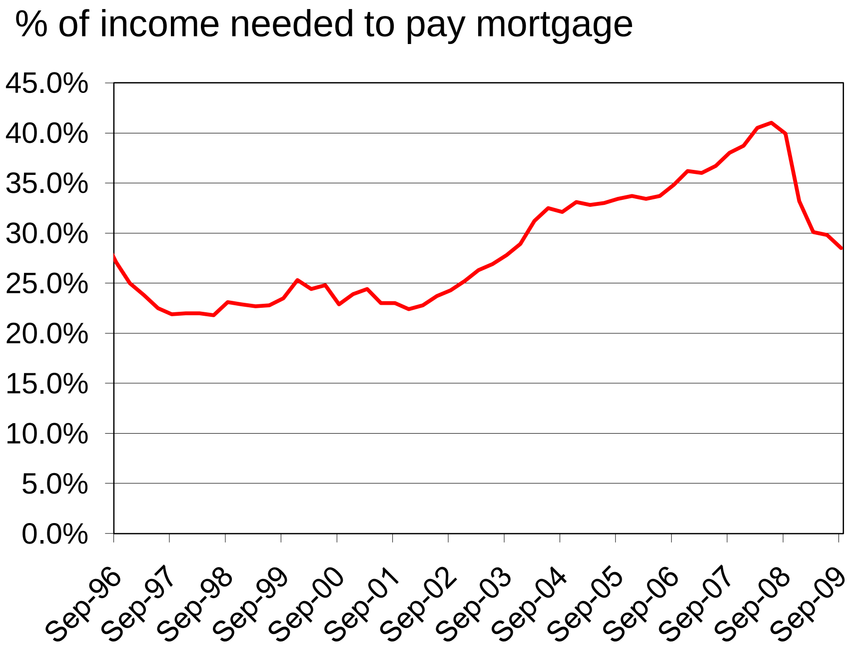


- Dwelling approvals for houses were up 55% from the February low, while other dwellings were up 184%, but remained very weak.
- Total dwelling approvals for Brisbane 2009 were 12,937, well below the 15,400 in 2008 and 18,400 in 2009, despite the recent increase.
- Brisbane's population grew at 43,400 in the year to June 2008. Figures for 2009 are not be released until late March, but Brisbane has averaged just over 40,000 annual population growth since 2004. Given the surge in QLD's population in 2009, Brisbane's population growth should also have risen.
- Allowing 2.6 persons per dwelling (Census 2006), dwelling approvals of 12,937 in 2009 would house population growth of 33,640. Even before the consideration of demolitions and non starts, the market is woefully under supplying.
- Brisbane would need annual approvals of between 16,000 and 18,000 to house population growth of 40,000 to 44,000.

Source: ABS
Analysis: Westpac Property

Affordability bottomed out in Q3 2009 and is expected to rise during 2010

Home loan affordability - Queensland



Source: REIA

- The lowest interest rates in around 50 years have played a major part in boosting the residential market over 2009. Affordability, which became a major bind in 2007 as mortgage rates rose close to 10%, have dropped dramatically during the year. As at September 2009, at 28.5%, affordability was back at late 2003 levels.
- However, in Q4 2009 interest rates have hiked 75bps and mortgages further. This combined with strong house price growth should mean the bottom of the affordability market was in September 2009.
- However, the impact of the rising rates is unlikely to be a significant as higher level of debt. Should mortgage rates rise to 7.50% by mid 2010, as expected by WBC Economics, the proportion of household income (assuming a 4% rise) needed to pay the mortgage would rise to around 34% or 2006 levels. Up to Q3 2009, the average loan size had been relatively stable in QLD. ABS data for Q4 suggests that it had started rising again which would impact on the above affordability measure.

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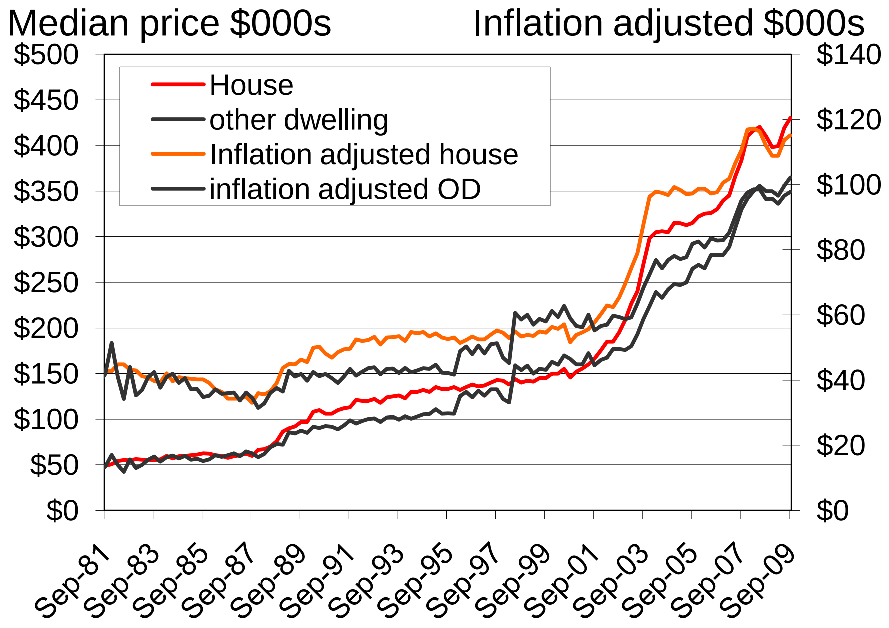
Prices surge from March, slowdown expected but no falls in 2010

Brisbane median house & other dwelling prices



Raw data: REIA and ABS
Analysis: Westpac Property

- Last year we considered that despite improving affordability, concerns over a recession and job security could drive prices lower during 2009. While our year on year figure was wrong, the trend in 1H 2009 matched our expectations.
- Brisbane median house prices were 4.9% higher in Q3 2009 than a year earlier. Growth in other dwellings was 4.3%. In the first half of our forecast, prices fell by between 1.4% (other dwellings) and 2.7% (houses). However, the boost from surging confidence and low mortgage rates led to price growth of 8% for houses and 6% for other dwellings between Q1 and Q3 2009.
- ABS data suggests that the rate of growth has accelerated in Q4, growing by almost 4.4% in the quarter for houses.
- While the current annual level of double digit price growth is unsustainable, the lack of supply, improving confidence and only average level mortgage rates could sustain growth of around 5% in 2010 as rising jobs lift income levels and debt levels rise further.

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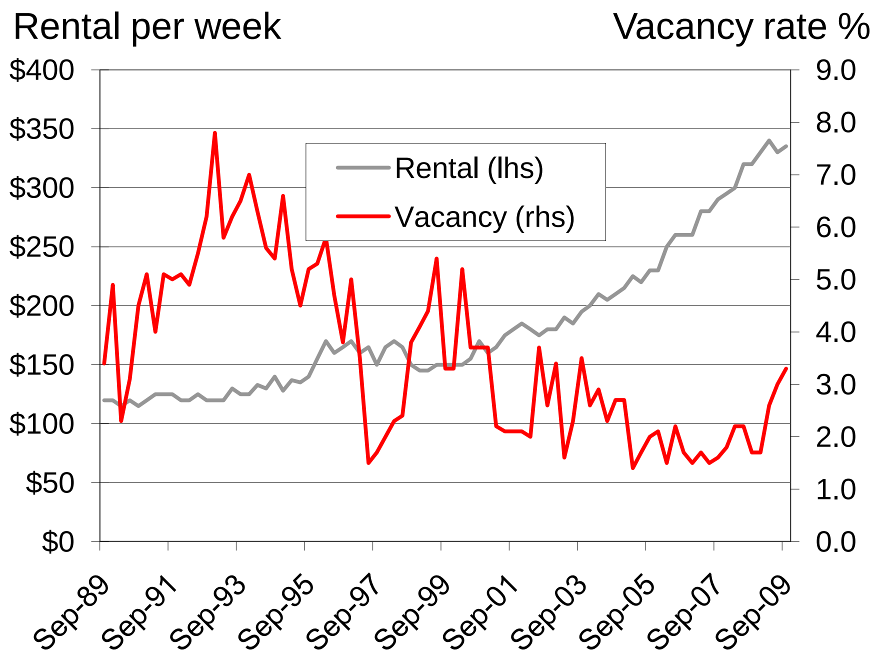
Vacancy surged in 2009 however rents flattened

Rental and vacancy - Brisbane



Source: REIA

- Vacancy rates almost doubled in the six months to September 2009. While we believe Brisbane is under suppling with new stock, part of the increase could be due to FHBs vacating the rental market. However, the extent of increase, a rise from 1.7% to 3.3% by Q3 2009, appears excessive.
- We forecast vacancy to fall into 2010, particularly as the FHBs exodus has ended and new supply remains low.
- We believed the low mortgage rates plus the FHB boost in 2009 would impact on rents, as landlords looked to retain tenants. Rents rose 4.7% in the year to Q3 2009, above forecasts, but fell in the six months to Q3 2009.
- Rising mortgage rates and the lack of FHB boost, should drive rents higher in 2010. However, if the 3.3% vacancy is correct, the extent of increase in the first half of the year could be muted.

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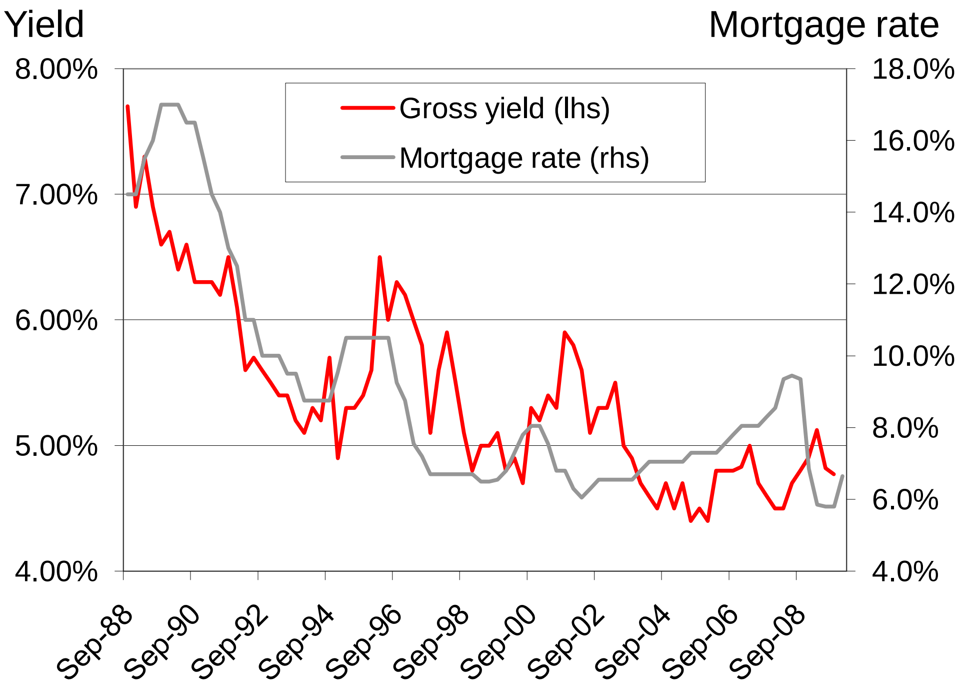
Yields to ease marginally as early price growth outpaces rental growth

Gross residential yields against mortgage rate – Brisbane other dwellings



Source: REIA/RBA
Analysis: Westpac Property

- Investment yields were 4.8% as at September 2009, unchanged from Q3 2008. Our forecast was for yields of above 5.0% by year end. However as prices fell, yields increased to 5.1% by the March quarter. Stronger than expected price growth and a lack of rental growth in the six months to Q3 2009 resulted in yields easing again to 4.8%.
- The strong price growth in Q4 2009 is expected to ease into 2010, but should lift prices faster than rents. Rents are expected to be hindered by higher than expected vacancy in early 2010. This is likely to drive yields marginally lower into 2010 to around 4.7%.

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Brisbane Office

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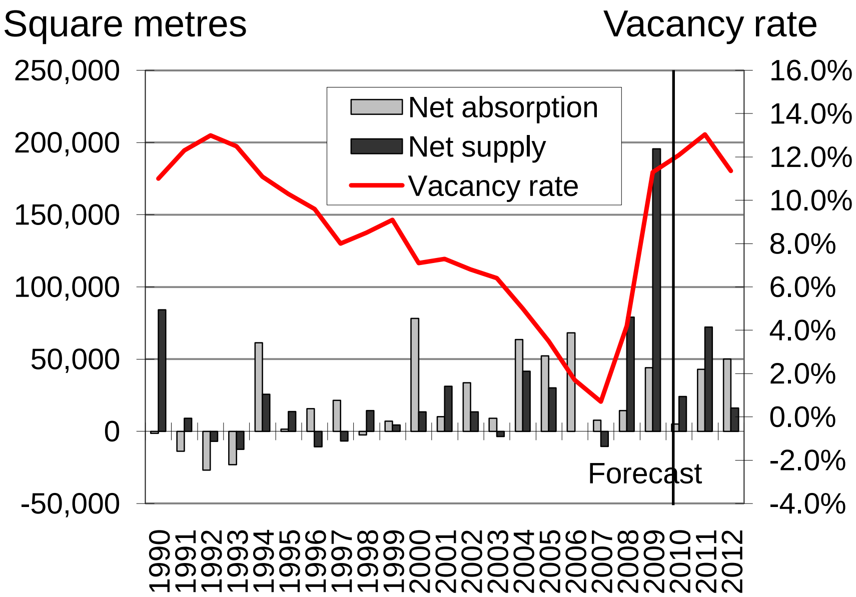
Brisbane CBD office market near peak, but supply continues

Supply, demand and vacancy in Brisbane CBD



Source: Historical data: PCA Office market report 2010

Forecasts: Westpac Property

- As forecast in last years Outlook, CBD vacancy soared as supply outpaced demand. However, while vacancy rose from 4.2% at the end of 2008 to 11.3% by the end of 2009, we had forecast over 14%.
- The economic recovery in late 2009 led to stronger than expected net absorption in 2H 2009 of over 40,000m^2 – we had predicted around 9,000m^2.
- The outlook for CBD is for rising vacancy over the next two years, even though supply is set to slow significantly and net absorption pick up to above average from 2011. The relocation of Energex from the CBD will impact on occupancy and subdue net absorption in 2010.
- With high vacancy, withdrawals are likely to be minimal. Therefore the completion of 111 Eagle Street in 2011 will add around 3% to stock and impact on vacancy. As such vacancy is forecast to peak at 13% in 2011.
- However, the potential for demand is likely to be on the upside further into the forecast should the economy and resource sector perform as expected and some companies take advantage of the lower net effective rents on offer to provide for future needs.

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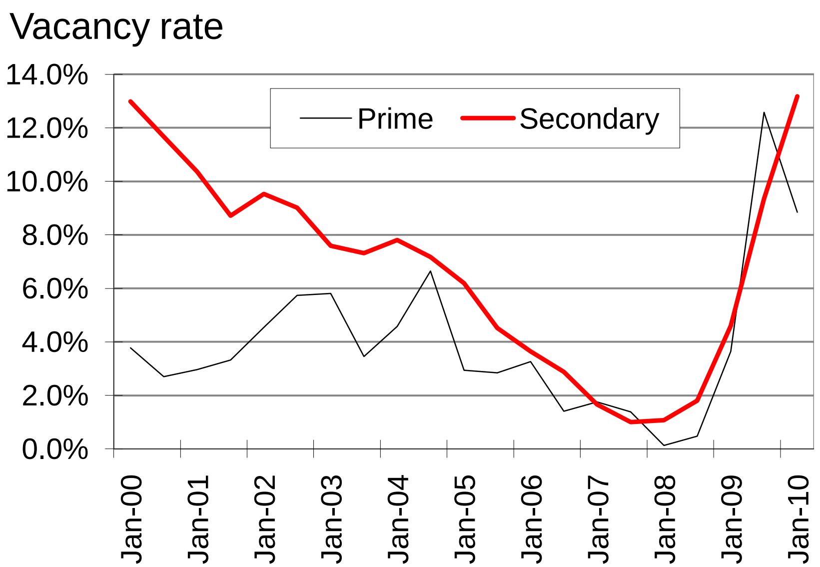
Shift to quality starts in 2H 2009 as tenants take advantage of cheaper rents

Vacancy by grade – Brisbane CBD



Source: Historical data: PCA Office market report 2010

Forecasts: Westpac Property

- Analysis of vacancy by grade shows the impact that the new supply has had on vacancy by grade. The completion of almost 120,000m^2 of prime office space in 1H 2009 caused prime vacancy to surge as the unleased space was added to the market. Similarly the relocation of tenants from older stock into the new stock lifted secondary vacancy.
- In 2H 2009 little new stock was completed, yet prime vacancy fell as up-graders took advantage of high incentives and low effective rents to relocate from secondary stock.
- There were some 78,300m^2 of prime space vacant in the CBD as at January 2010, down from 106,000m^2 in July 2009. Average prime net absorption over the past five years has been around 30,000m^2. However, some 70,000m^2 of upgrading occurred with the new completions in 1H 2009 and is likely to have satisfied a number of firm's need for better quality space. While the economy is expected to pick up, it is likely the market will remain competitive for tenants for at least the next year in order to lease up the vacant prime space.

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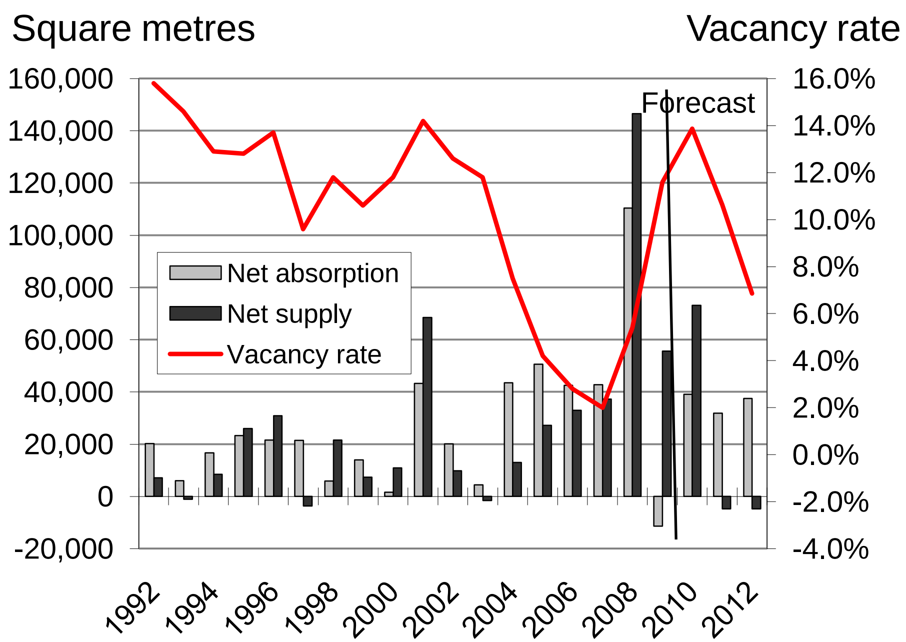
Brisbane ‘near city’ supply continues, vacancy to worsen

Supply, demand and vacancy in ‘Near City’ Brisbane



Source: Historical data: PCA Office market report 2010

Forecasts: Westpac Property

- The high supply which hit the Brisbane near city market in 2008 continued into 2009, albeit at a slower pace. Some 56,000m^2 was completed in the year, but with minimal withdrawals most was added to total stock.
- In addition to the high supply, the region lost tenants to the newly completed space within the CBD and also the economic slowdown. Although only 12,000m^2 was lost this was the equivalent of just over 1% of occupied stock. Vacancy rose to 11.6% by the end of the year, against our forecast of 11%
- Supply remains high into 2010, as the Leightons HQ and Energex building are completed. However, with the latter relocating from the CBD, the impact on vacancy will be muted.
- Continued high supply in 2010 should lift vacancy from 11.6% in 2009 to a peak of 13.9% in 2010, which is lower than our mid year forecast of 19% due to the improved economic outlook.

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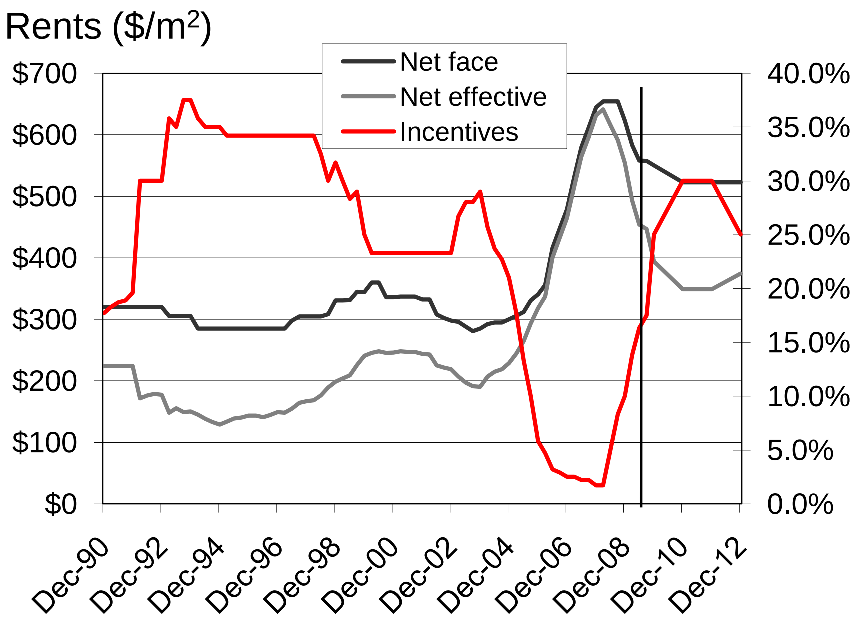
Brisbane CBD rents to continue falling

Prime net effective rents – Brisbane CBD



Source: CB Richard Ellis historic data to December 2009

Forecast: Westpac Property

- In last year's Outlook we forecast falls of 18% for prime net effective rents in 2009, as incentives rose to 25%, with further falls forecast for 2010. While incentives lifted to 25% by year end, net effective rents fell by 28% by Q4 2009 and were some 38% lower than at the peak. In August we increased the peak to trough rental fall to 50%.
- The continued level of supply is unlikely to result in any reduction in incentives during 2010, particularly with 111 Eagle Street to be completed in 2011.
- We maintain our view that incentives could peak at 30% over the next year, but that an improving level of demand may well fill prime vacancy faster than expected, enticed by the incentives. Further declines of 11% in effective rents are expected in 2010, with a peak to trough fall of over 45% by the second half of the year.

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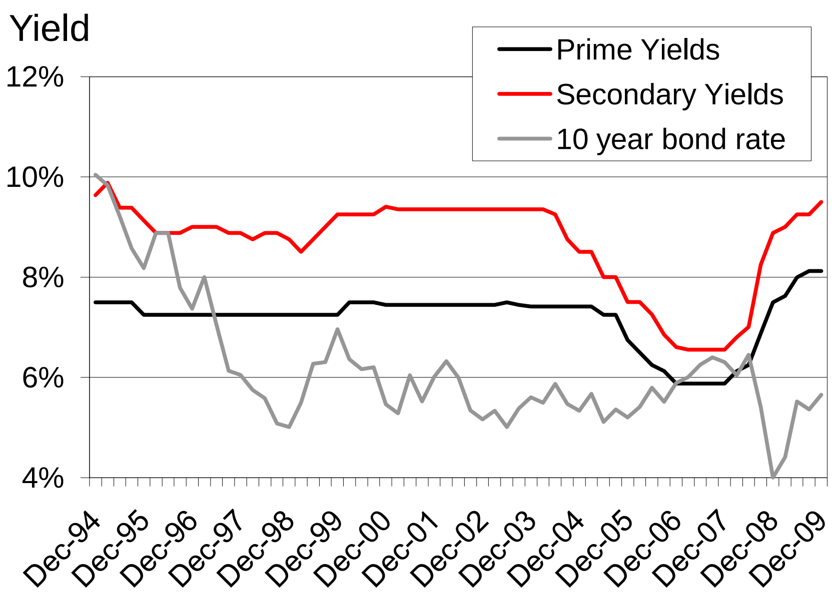
Yields continued to ease, with signs of stabilisation in Q4 2009

Prime and secondary yields against the 10 year bond rate



Raw data: CB Richard Ellis PTY Ltd, RBA
Analysis: Westpac Property

- Rising vacancy, falling rents and weak sentiment (particularly in 1H 2009) impacted on yields through the year. Prime yields eased a further 63bps to 8.13% and secondary by 62bps to 9.50%.
- Although these yields now look attractive when compared against 10 year average or even risk premium to 10 year bonds, the concern is the continued rise in vacancy expected through to 2011 and the impact on occupancy. While further rental falls should have been priced into the yields, the concern lies around the security of income.
- Values have fallen by 38% for prime properties and 46% for secondary properties since the peak.
- While we do not foresee any further easing in yields, values could fall slightly further in 2010, particularly for secondary or unleased properties before plateauing from 2011.

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Outlook for Australian Property Markets 2010-2012

Brisbane Retail

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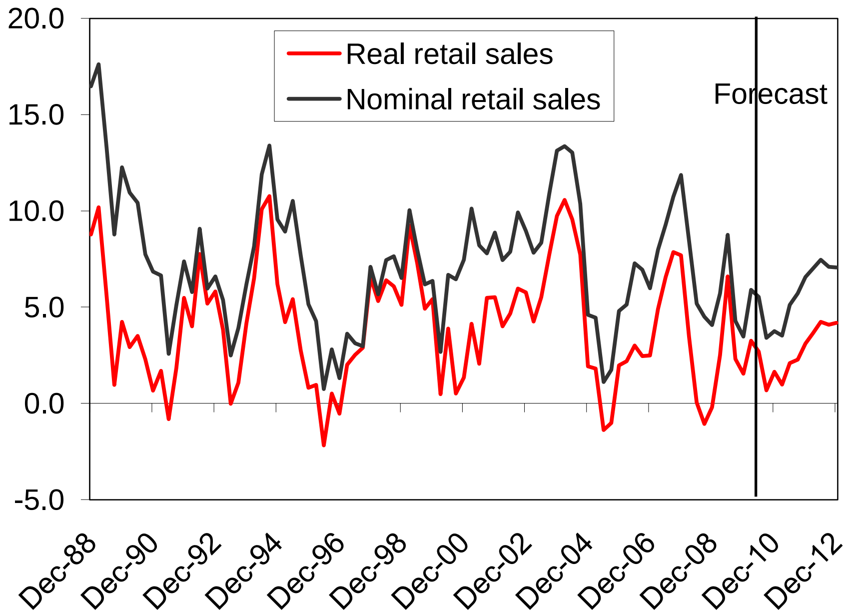
Retail sales slowed in 2H 2009, and rising rates are expected to impact further

Change in retail sales

Change on same qtr in previous year (%)



Source: ABS

Forecast: Access Economics

- Queensland, as with the rest of the country, benefited from the cash handouts. Retail sales grew 4% in 1H 2009, with June quarter sales almost 9% higher than a year earlier.
- However, while retail sales did fall, the expectations of a crash in 2H 2009 did not occur. Sales in the 2H 2009 were close to 0.4% lower than in 1H 2009, a reasonable result given the lack of handouts.
- Access Economics consider that despite a stronger economy, retail sales growth will slow into 2010 as higher interest rates curtail spending. Access forecast sales growth of 4% in 2010, picking up thereafter. We feel the 2010 figure may be a bit cautious given the extent of confidence, job and population growth expected.

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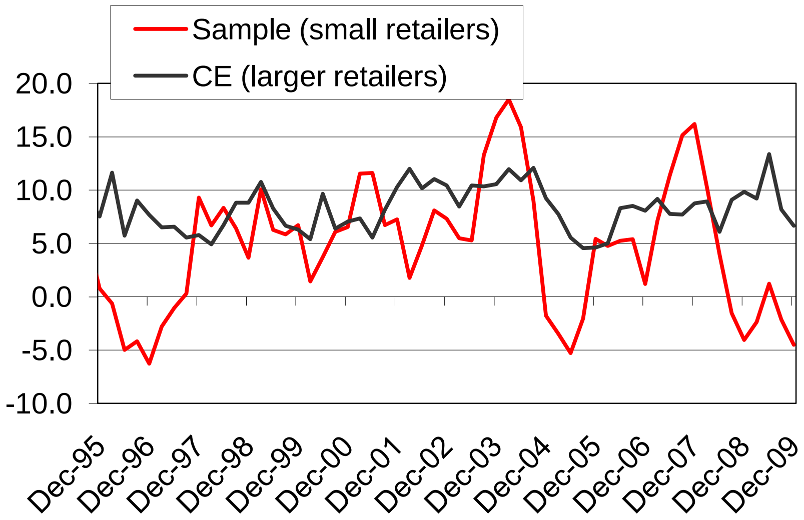
Queensland's smaller retailers limited benefit from handouts

Change in retail sales - Queensland

Change on same qtr in previous year (%)



Source: ABS

Forecast: Access Economics

- The breakdown of retail spending by smaller retailers, where the ABS takes a sample of retailers, and larger retailers who are completely enumerated (CE), shows who has benefited from the cash handouts in Queensland.
- Although the smaller retailer data mainly shows falling annual sales since Q3 2008, this was caused by large falls in Q1 2008 and 2009, with the data not seasonally adjusted. However, while the trend shows a minor increases in spending growth for the smaller retailer in the final 3 quarters of 2009, it appears from the annual figures that this hasn't been enough to counter the fall in Q1 2009.
- Larger retailers continue to grab increasing market share with continued annual growth of above 5%.

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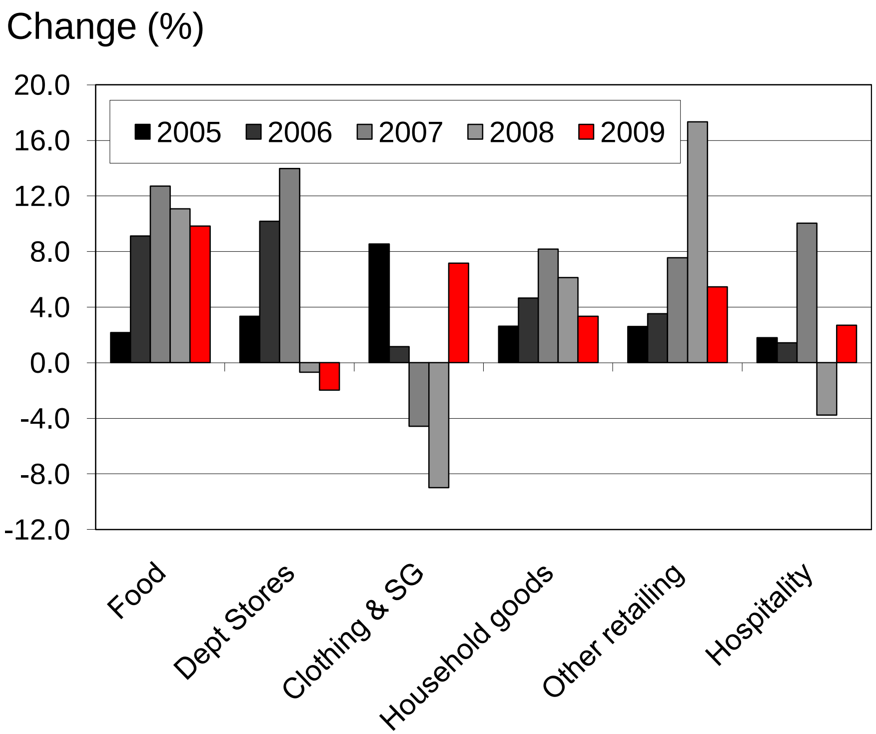
Food retailing remains steady, surprising bounce by clothing

Annual change in retail spending by sector - Queensland



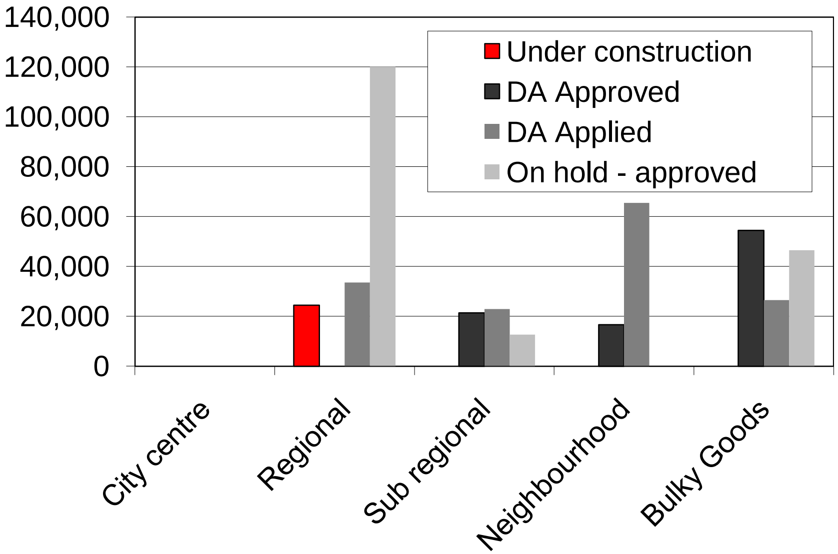
Source: ABS

- Analysis of sales by sector type reveals areas where tenant security or expansion is likely to emanate.
- Food based retail has been the most consistent performer over the past five years. 2009 was no different with growth of almost 10% for the year. The main drivers were supermarkets and liquor stores, posting double digit growth. Specialised food outlets had falling sales, not surprising given the economic climate early in 2009.
- While the slowdown in department store spending would be expected in a slowdown, the lift in clothing, even after two years of decline, was a surprise.
- Perhaps most surprising has been the resilience of household goods retail over the past two years.

Retail supply minimal

Future and possible retail stock Brisbane

Square metres

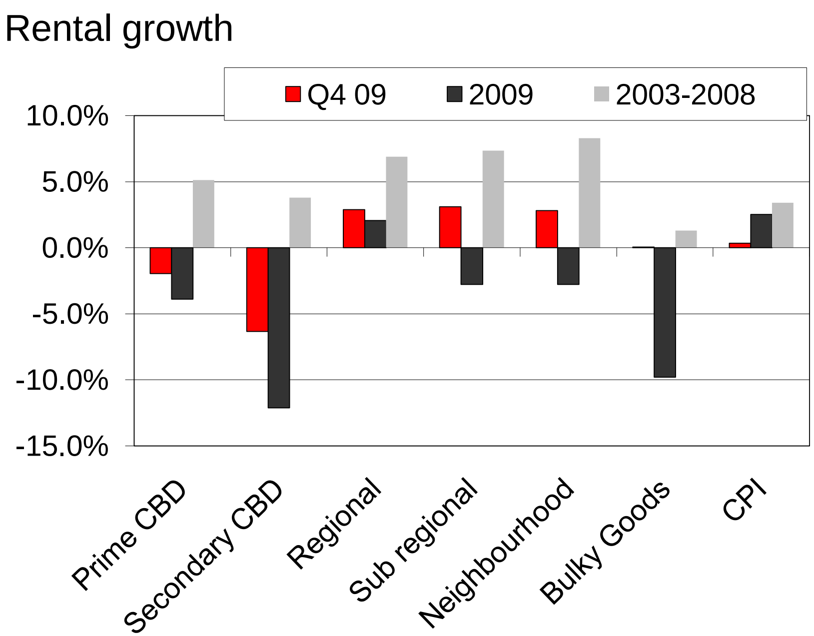


- The slowdown in retail sales and caution around how bad the downturn was going to get, has led to limited new supply under construction in either Brisbane or the South East corner of Queensland.
- Data from CB Richard Ellis suggest that there was just one shopping centre project underway in the Brisbane area, with only one other in the Gold Coast. Both were extensions to existing regional centres.
- Projects with development approval were scarce, although there were a few that had been placed on hold.
- Given Access Economics bearish view on retail sales the lack of supply at least in 2010 will help the market. With our view of stronger retail sales than Access expect, the market should improve over the forecast period.

Source: CB Richard Ellis Pty Ltd
Analysis: Westpac Property

Rents fell in 2009, stabilising in Q4, ex-CBD

Rental growth – Brisbane retail



Source: CB Richard Ellis Pty Ltd
Analysis: Westpac Property

- Last year we suggested that it wouldn't surprise to see secondary rents fall. While this occurred, particularly in the CBD, rents fell for most types of retail. The exception were Regional shopping centres in Brisbane during the year, where they matched CPI.
- There were signs of stabilisation in Q4 2009, although the weak retail sales data would not have helped confidence.
- The lack of new supply will help the market consolidate and rental growth in 2010 is likely, should retail sales growth strengthen, as we expect. However, should Access Economics forecast be correct, stability is likely to continue.
- Stronger rental growth is likely from 2011 as retail sales growth picks up.
- However, the split in sales by retail type suggests that strongest growth will continue to come from the centres with the major retailers, who continue to capture a greater market share of sales.

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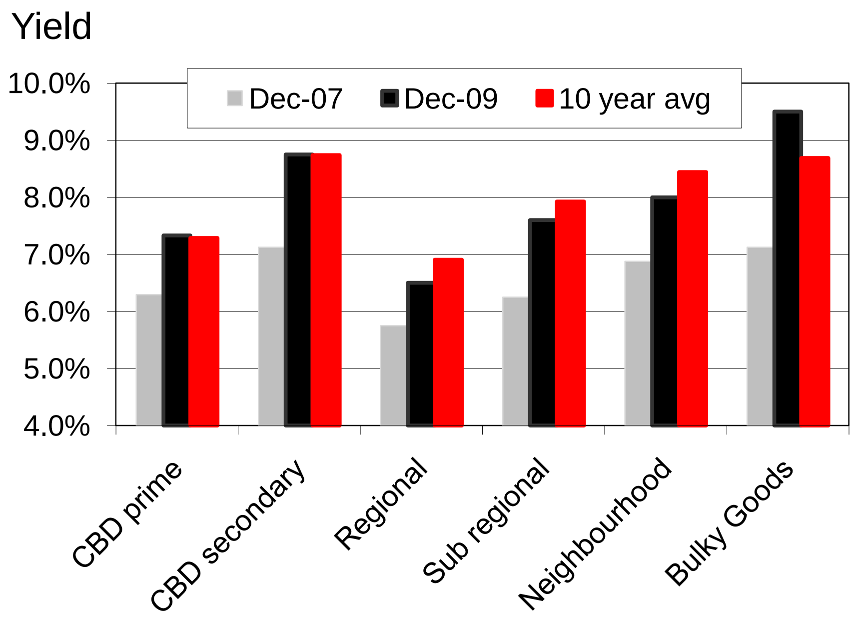
Yields stabilise in Q4 2009

Average yields – Brisbane retail



Source: CB Richard Ellis Pty Ltd
Analysis: Westpac Property

- The lift in retail yields across the Brisbane market stopped in Q4 2009, as some sectors posted minor firming of yields.
- While yields have eased significantly since the 2007 peak, they remain below 10-year averages for Regional, Sub regional and Neighbourhood shopping centres. CBD centres were close to average and bulky goods were well above average.
- Given the lack of rental growth outside regional shopping centres, the easing in yields appears too low and return to firming too quick. However, investors may consider rents will return to above CPI growth of the mid 2000s, something the retail sales forecasts for 2010 do not back up.
- However, a lack of supply and potential rental growth from at least 2011, should keep yields stable in 2010.
- There is a possibility that renewed investor confidence will place pressure on yields to firm slightly during the year. However, this is more likely for prime than secondary properties.

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Brisbane Industrial

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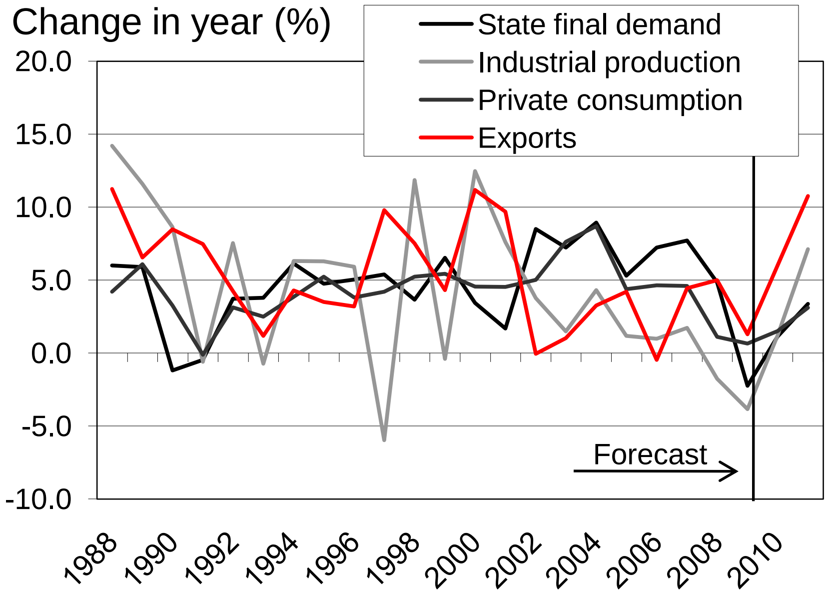
An economy rising from the slowdown to lift demand

Industrial drivers - Queensland



- Although Australia avoided the technical recession, the economy slowed significantly during 2009. Queensland gross state product (GSP), although remaining positive year on year, posted a decline in Q2 2009.
- Demand drivers for the industrial market also weakened during the year, with falls in two major drivers, state final demand and production. Consumption also slowed.
- However, the outlook is for growth over the forecast period, with slow growth in 2010, but picking up thereafter.

Source: Access Economics

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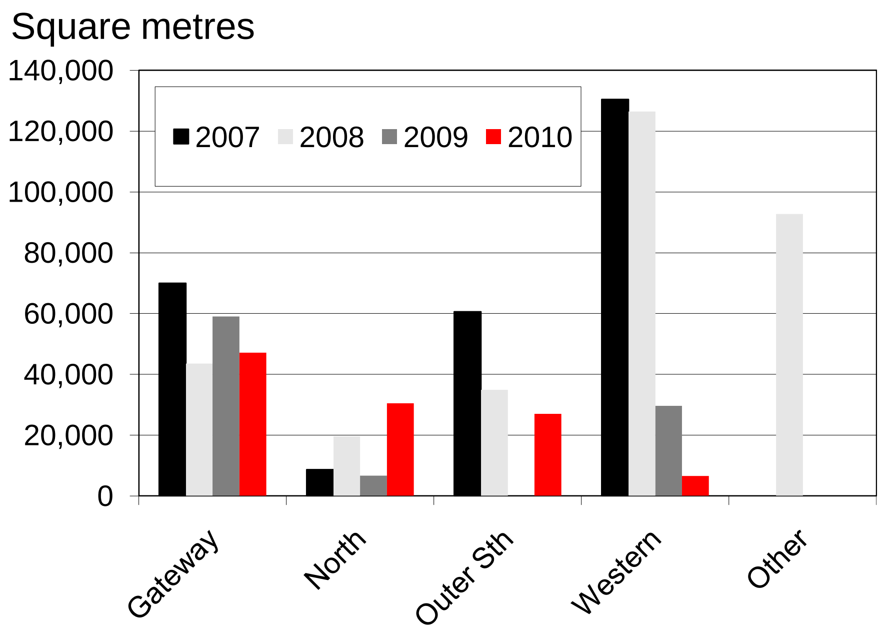
Supply minimal with pre-committed sock to lead starts

Industrial supply under construction
Year start



- Following a significant slowdown in new supply as 2008 progressed, new starts remained low into 2009. As at the end of 2009 only 111,000m^2 was under construction. This was slightly above the 95,000m^2 under way at the start of 2009.
- However, the slowdown from the years of high supply in 2007 and 2008 is evident. In both of these years new supply under construction was well closer to 300,000m^2 in each year.
- The new supply underway remains mainly in the Gateway precinct, as the soon to be complete second bridge allows greater access.
- Future supply is likely to remain subdued into 2010, with pre-committed stock likely to lead early starts.

Source: CB Richard Ellis Pty Ltd
Analysis: Westpac Property

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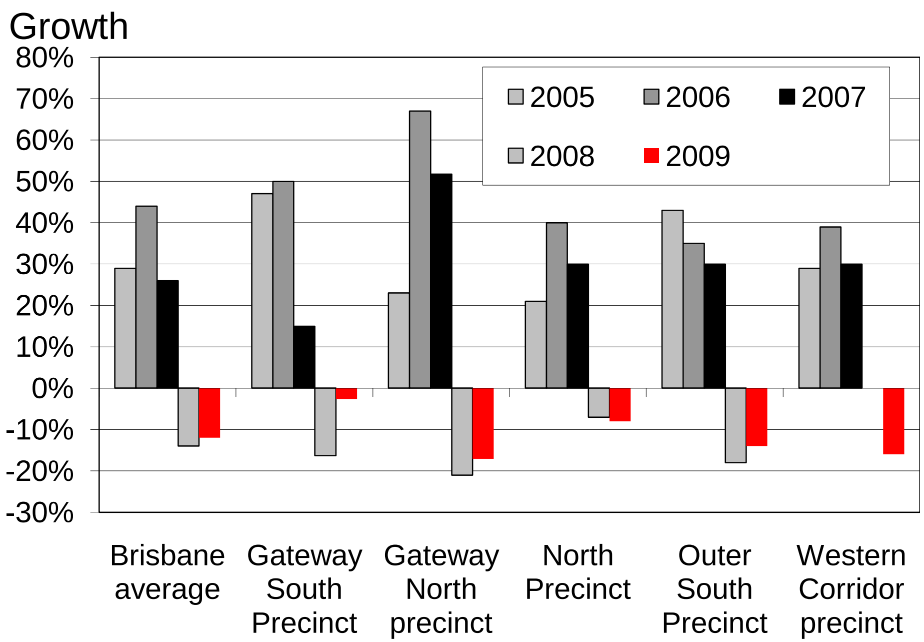
Land values fall over 2009, however will plateau in 2010

Annual land value growth - Brisbane



- Industrial land values continued to fall into 2009 following significant falls in 2008. Land values fell across all regions although to differing degrees. The majority of the 2009 fall was recorded in Q1.
- Most affected was once again the Gateway North precinct down by 17%, following the 21% fall in 2008.
- Land values have now fallen to around 2006 levels in most markets.
- A rising economy should help lift demand, and if rents are any indication vacancy is falling, which may lift the attention of developers later in the year.
- However, land values should stabilise over 2010, following trends seen in 2H 2009.

Source: CB Richard Ellis Pty Ltd
Analysis: Westpac Property

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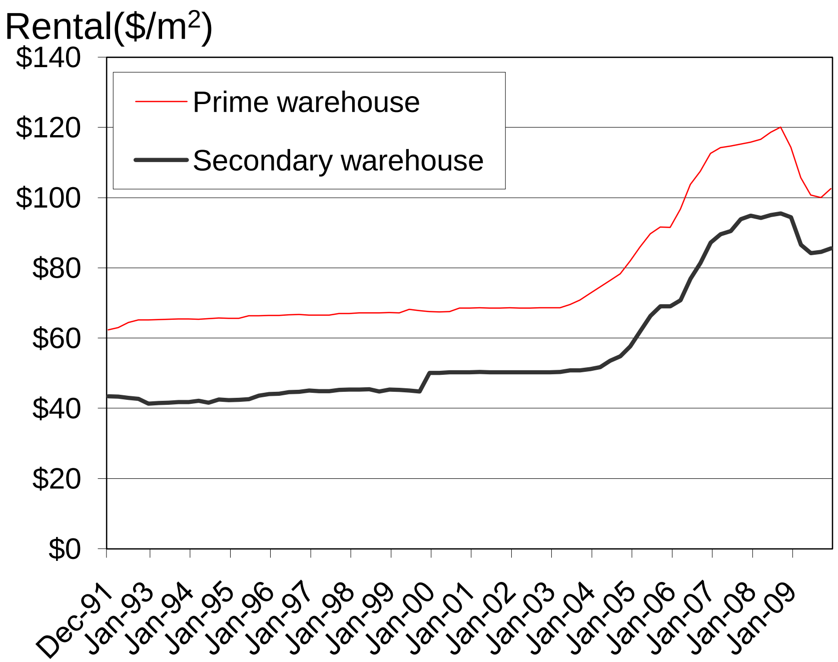
Rentals fall in 1H 2009, signs of lift late in year

Net effective rents – Brisbane

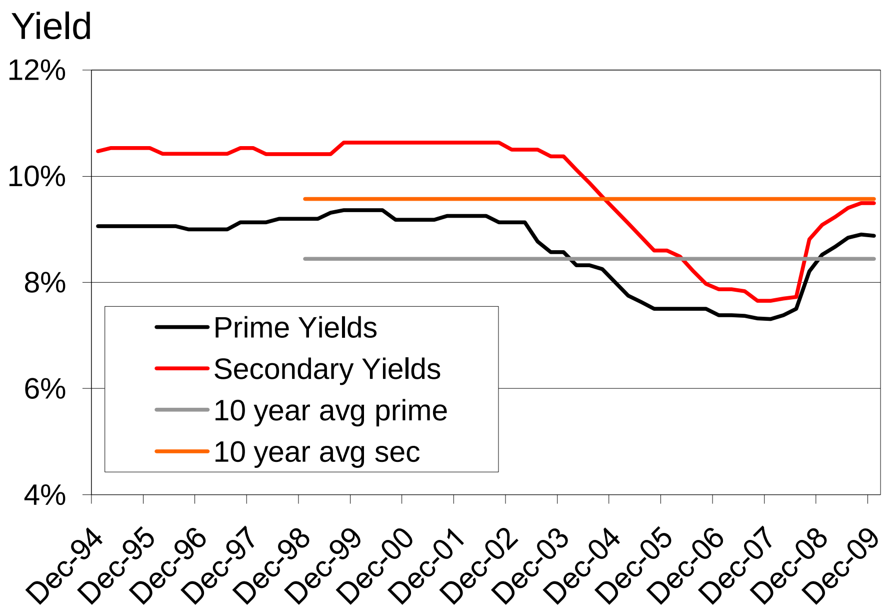


Source: CB Richard Ellis Pty Ltd
Analysis: Westpac Property

- Prime net effective rents fell by some 17% in the year to Q3 2009, but showed some signs of recovering in the final quarter.
- Secondary net effective rents also fell but surprisingly by less than prime space, at only 11.5%. Signs of stabilisation or a mild increase was evident by year end.
- The increases were across most markets and driven largely by falling incentives, which suggest improving vacancy.
- The result is a bit surprising given the weakness of the economy, supposed weak demand and high vacancy in the first three quarters of the year.
- With a sluggish recovery predicted by Access Economics, pressure on rents is unlikely to increase too significantly in 2010. However, the lack of new supply should allow vacancy fall further, which should result in rental growth increasing from 2011.

Yields ease in 1H 2009 but stabilise towards year end

Prime and secondary yields against the 10-year average - Brisbane



- While we expected yields to continue to ease into 2009 as sentiment remained weak, we forecast that secondary yields would ease most. Although this did occur, the extent of easing for secondary was not as far as we expected.
- Average prime yields have moved well above the longer term average and sit around the 8.9% level as at the end of 2009. However, secondary industrial yields are only 50bps higher.
- With expectations of investor sentiment lifting into 2010, pressure could come into prime yields to firm, particularly for well leased, secure income properties.

Raw data: CB Richard Ellis PTY Ltd, RBA
Analysis: Westpac Property

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