



Outlook for Australian Property Markets 2010-2012

Adelaide

Update August 2010



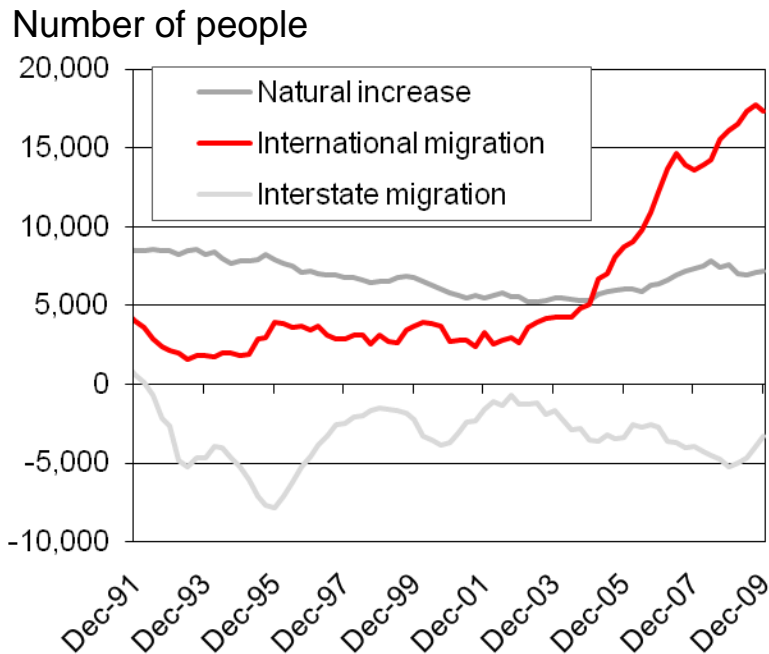
Outlook for Australian Property Markets 2010-2012

Adelaide residential

Update August 2010

Population growth to slow, with lower international migration

Annual population growth – South Australia



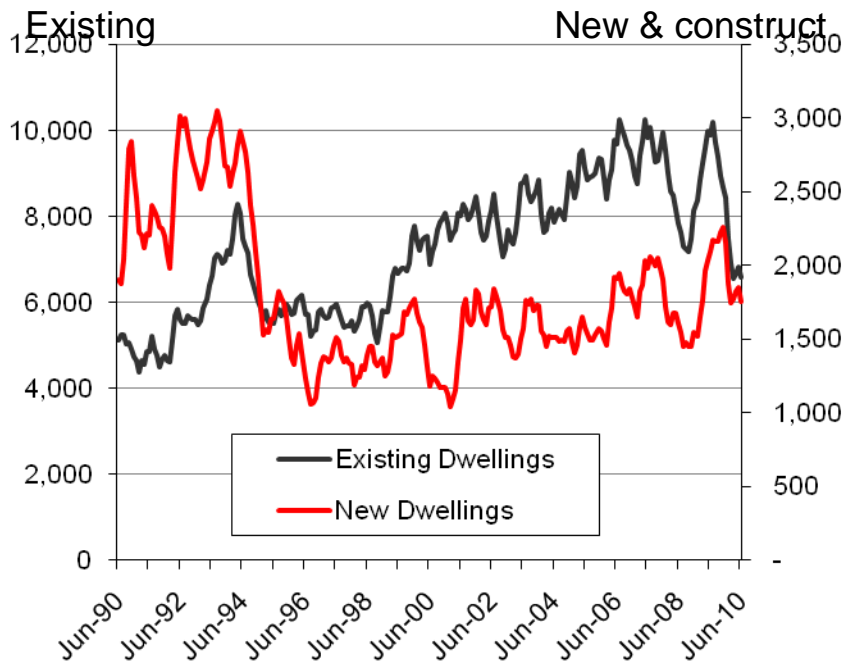
Source: ABS

Analysis: Westpac Property

- Population in South Australia increased by some 21,228 people, or 1.3% in 2009 in comparison to 18,507 people, or 1.2% in 2008. The 10-year average growth rate for SA's population is 0.8%.
- Although numbers are falling, international migration continued to be the main driver of population growth, with a net 17,349 people moving to SA in 2009.
- Interstate migration remains weak, with the state losing some 3,317 people to other states in 2009. The rate of decline continues to slow.
- Annual growth for natural increase continues to trend along at a relatively stable rate. Some 7,196 people contributed to the 2009 population growth via natural increase.
- Access Economics suggests that the rate of annual population growth is likely to slow to around 1% over the forecast period as a result of a more stringent migration policy. This is still higher than the 0.8% 10-year average rate.

Demand levels to improve over 2H 2010 as interest rates remain on hold

3 month rolling finance commitments for existing and new dwellings - SA



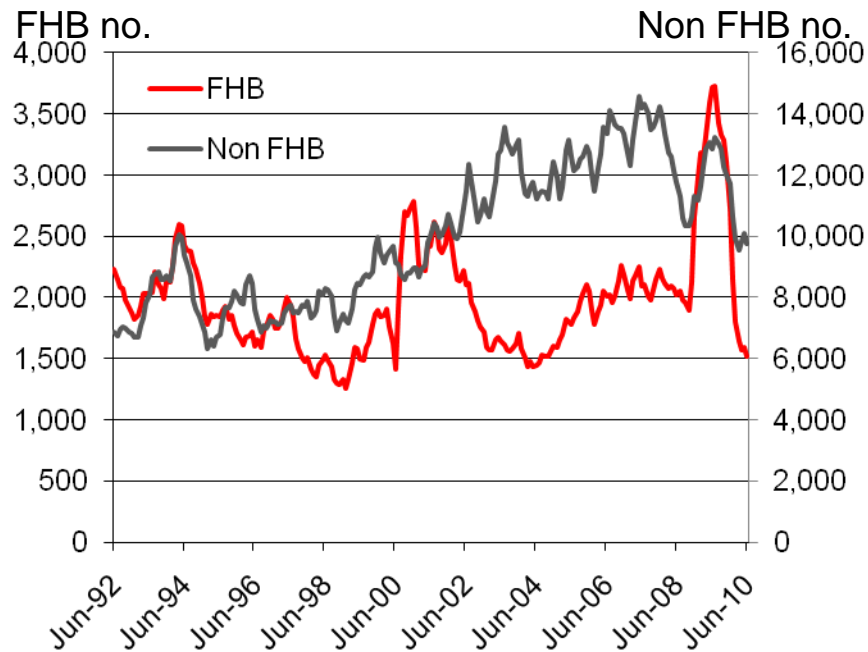
Source: ABS

Analysis: Westpac Property

- In our February Outlook publication we had suggested that owner occupier demand may improve over 1H 2010 before affordability factors impacted negatively on demand over 2H 2010. While we were correct in suggesting affordability would weigh down on demand, we were incorrect on the timing of this occurring. Demand declined over 1H 2010 in comparison to 2H 2009.
- Finance approvals to buy or construct new dwellings declined by 18.4% over 1H 2010 while finance approvals to buy an existing dwelling fell by 26.3%. Demand was weakest in Q1 2010, with levels recently stabilising.
- Demand is expected to stabilise over Q3 2010 before minor improvements filter through from Q4 as interest rates remain stable. Demand is likely to be volatile over 2011 as affordability deteriorates in a rising interest rate environment. Westpac Economics are forecasting the cash rate will increase to 5.25% by the end of 2011.

Non FHBs to drive lift in demand later in 2010

Housing finance for FHB and non FHB 3 month rolling totals – SA



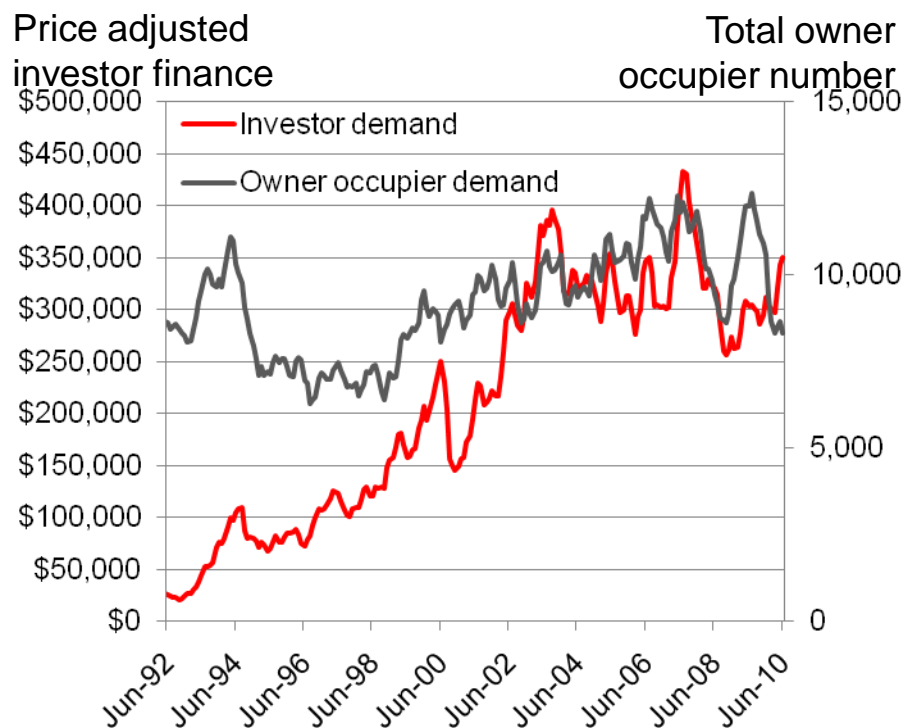
- The number of First Home Buyers (FHBs) in SA peaked in July 2009 when the cash rate reached a 50-year low of 3.00% and the FHB Boost was in place. As elsewhere nationally, falls in the number of FHBs as interest rates begun rising in October 2009 has been quite significant. FHB numbers in June 2010 were some 59% lower than its peak and were 28% below 10-year average levels. The majority of weakness occurred over 1H 2010, however the rate of decline in FHB numbers is slowing.
- The decline in non FHB numbers since peaking in July 2009 is also significant, with numbers down by some 26%. As with the FHB market, the majority of weakness occurred in 1H 2010 and numbers are currently at levels last seen in 2004. Demand by non FHBs does however appear to be recovering, with growth of 0.7% occurring in both June and July.
- The slight improvement in owner occupier demand later in the year is expected to be driven by the non FHB market.

Source: ABS

Analysis: Westpac Property

Investor demand rising

Price adjusted 3-month rolling investor demand vs owner occupier demand - SA



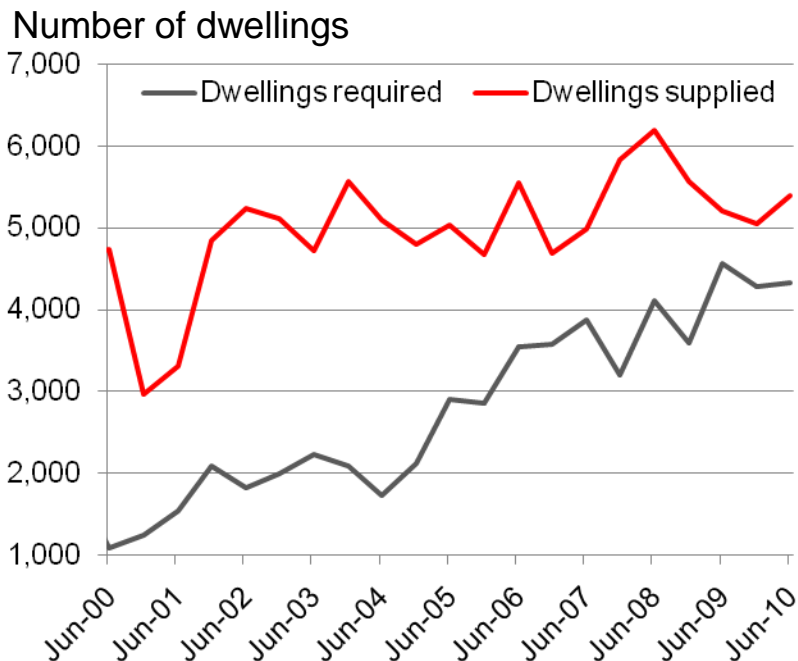
- As expected, investor demand in SA, strengthened over 1H 2010, with investors likely attracted to the lower cost of housing in comparison to other capital cities. Investor demand, as measured by price adjusted investor finance levels, increased by some 12% over 1H 2010 despite three interest rate rises totalling 75bps over the same period.
- The most recent figure for June indicates that investor demand in SA was at its highest level since December 2007. Annually, numbers were up by some 16% in June.
- Investor demand is likely to improve further over 2H 2010 as interest rates remain stable and yields improve. Investor levels are likely to steady over 2011 as rising interest rates start to affect confidence and affordability.

Source: ABS

Analysis: Westpac Property

SA appears to have been over-supplying residential stock over the last 10 years...

6 monthly dwellings supplied versus what is required - SA



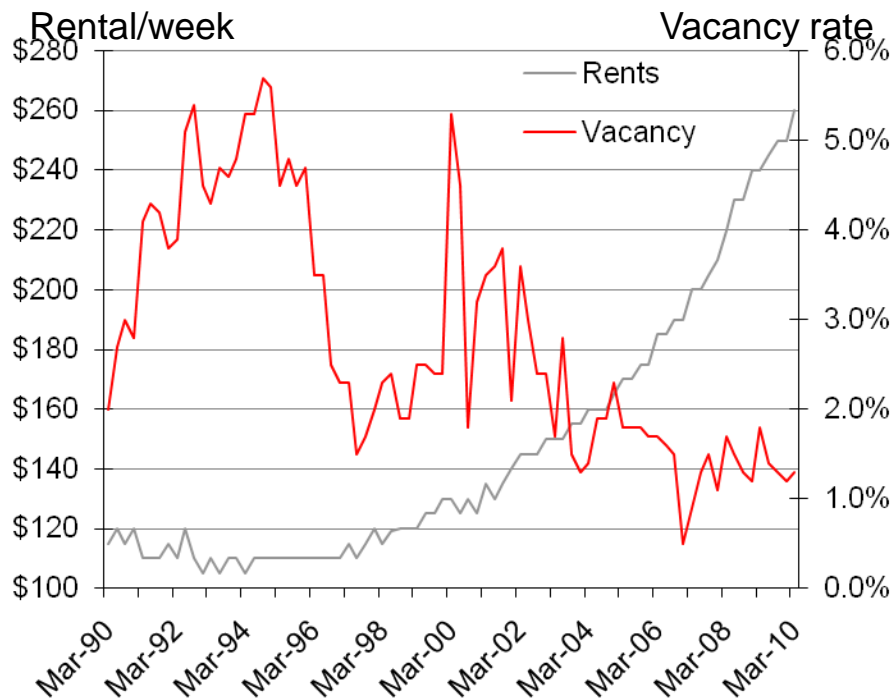
Source: ABS and Access Economics

Analysis: Westpac Property

- Analysis indicates that SA has had excess supply over the last 10 years. Dwellings supplied has continually been higher than population growth generated requirement, however it does appear as though the gap is closing.
- On a cumulative basis, population growth between December 2008 and December 2009 generated a need for some 8,845 dwellings at 2.4 persons per dwelling, as per the 2006 Census data. During the same time period and taking into account a 95% conversion rate and a demolition rate of 1%, some 10,261 dwellings were supplied. In 2009 alone, this indicates an oversupply by some 771 dwellings.
- However, the performance of the Adelaide market with rising values, rising rents and low vacancy suggests that structural change is absorbing any oversupply.

However the residential vacancy rate indicates supply levels are not high enough...

Rentals and vacancy - Adelaide



- As suggested, despite statistical analysis indicating that SA has been supplying too many residential dwellings, the residential vacancy rate is indicating otherwise.
- According to REIA, vacancy in Adelaide was recorded as being 1.3% as at March 2010. The current vacancy rate is 50bps lower than a year ago and remains below its 2.6% long term average rate. A below average vacancy rate generally indicates an undersupply of dwellings.
- As expected, low vacancy rates and above average population growth led to rents for 2 bedroom other dwellings increasing. Over Q1 2010, rents rose by 4.0% to a median value of \$260/week. Rents are now 8.3% higher than a year ago.
- We maintain the view that rising interest rates are likely to push rents up further over 2011.

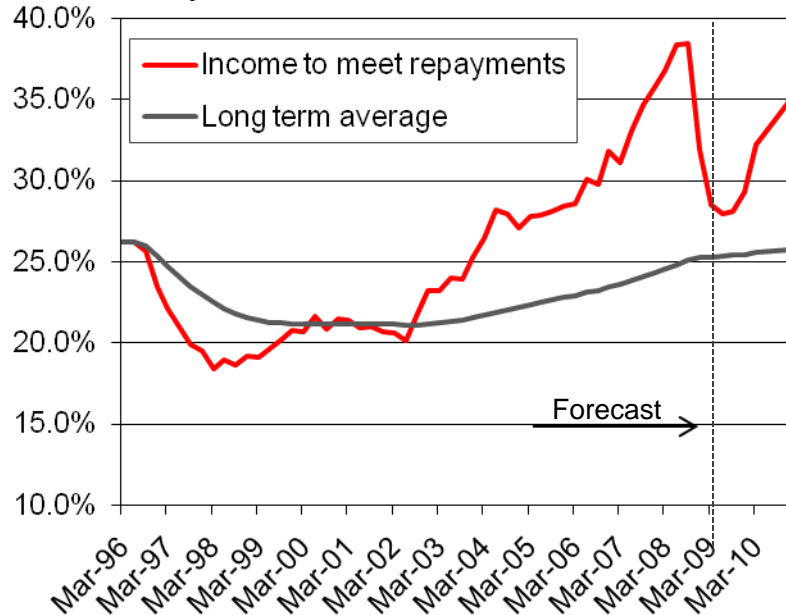
Source: REIA

Analysis: Westpac Property

Affordability to remain a challenge in SA as interest rates rise

Home loan affordability indicator - SA

Affordability Indicator



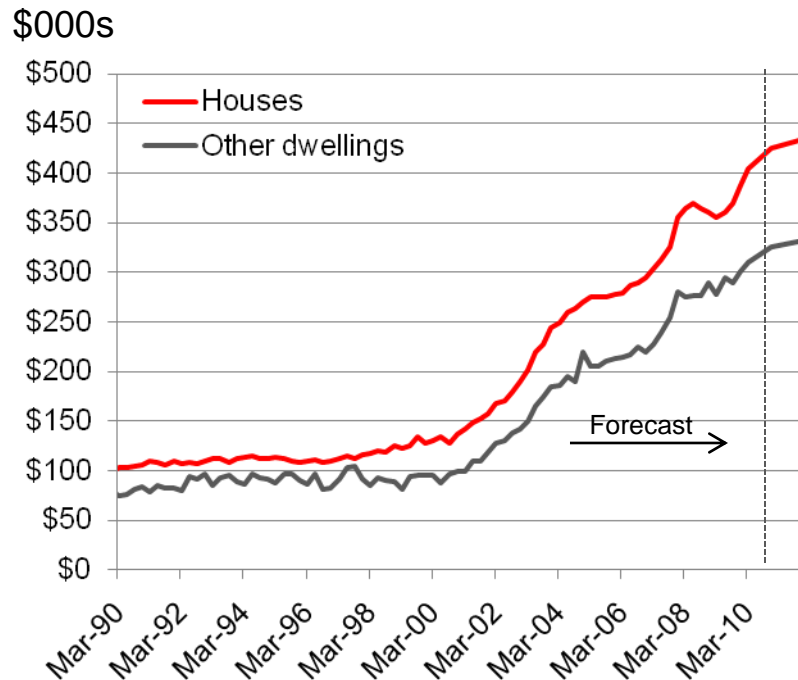
Source: REIA

Analysis: Westpac Property

- As expected, the proportion of income required to meet average monthly mortgage repayments in SA increased from 28.5% a year ago to 32.2% in March 2010. Rising interest rates and house prices were the drivers of the deterioration in affordability levels. On a national level, SA sits in the middle, being the fourth least affordable state.
- The proportion of income required to meet average monthly mortgage repayments is expected to increase further, driven by rising prices over 2H 2010 and by interest rate increases over 2011.
- We maintain the view that affordability will remain a drag on potential price growth in SA as it remains well above either the long term average of 26% or the five year average of 31%.

Residential prices are at historical highs with more price growth to come...

Adelaide median residential prices



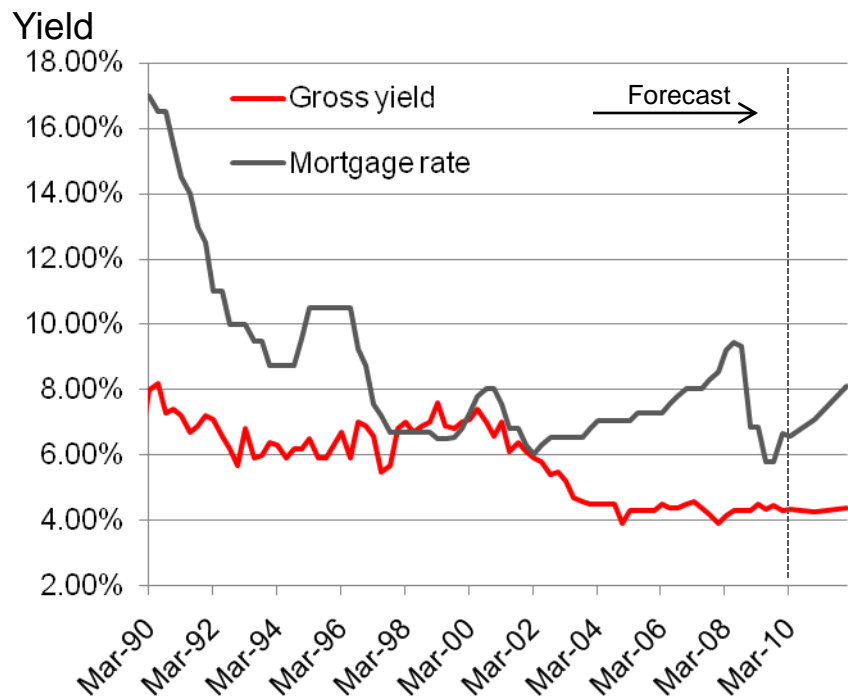
Raw data: REIA

Analysis and Forecasts: Westpac Property

- As expected, median prices in Adelaide continued to increase over Q1 2010. Over the quarter, the median house price in Adelaide rose by 4.5% nominally to \$405,000, leading to an annual increase of some 14.1%. Median prices for other dwellings increased by 3.0% nominally over Q1 to \$310,000, resulting in annual prices to be up by some 11.8%.
- Despite interest rate increasing by 100bps over the year to March, both house and other dwellings values in Adelaide are at their highest levels on record. The ABS suggests prices continued to increase in Q2 2010, by 3.2%.
- The momentum in price growth is expected to slow over 2H 2010, despite interest rates remaining stable. Deteriorating affordability is likely to limit growth to below CPI levels over 2011.

Investors do not appear to be deterred by Adelaide's low yield

Gross residential yields against the mortgage rate - SA



- As expected, the gross residential yield fell slightly in Adelaide, from 4.5% a year ago to 4.4% in Q1 2010. Higher price growth than rental growth drove the slight fall in the yield.
- The current yield remains lower than the 10 year average of 5.0% and continues to be one of the lowest yields nationally. Despite having one of the lowest yields nationally, investor demand has been strongest in Adelaide over 1H 2010.
- We maintain the view that with rental growth and price growth forecast at similar rates over 2H 2010 and into 2011, Adelaide's yield is expected to remain around current levels through to the end of 2011.

Source: REIA & RBA
Analysis and Forecast: Westpac Property



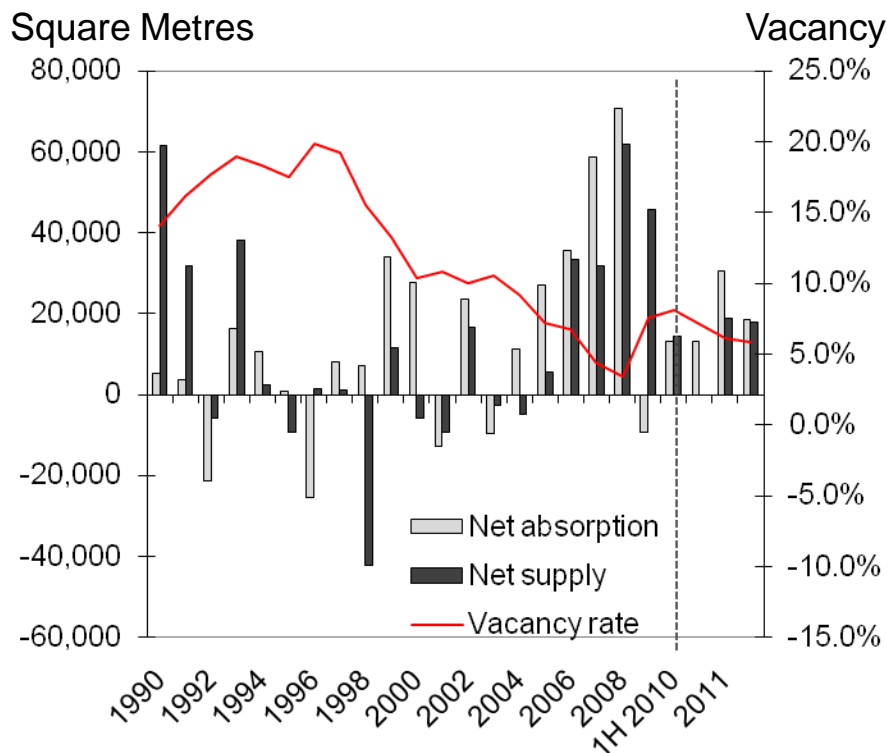
Outlook for Australian Property Markets 2010-2012

Adelaide offices

Update August 2010

Demand to outstrip supply resulting in vacancy to be sub 6% by the end of 2012

Supply, demand and vacancy in Adelaide CBD (Core & Frame)



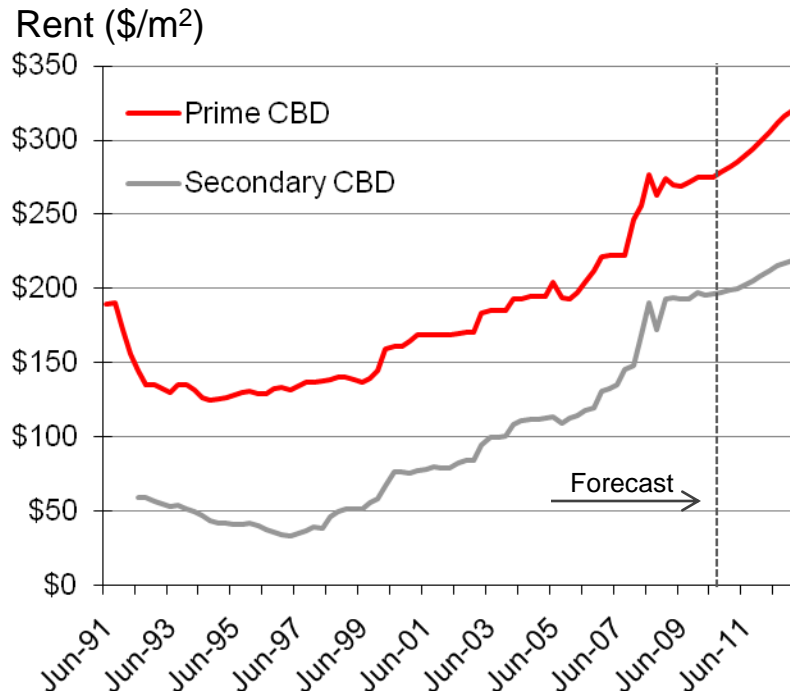
Source: Historical Data: PCA OMR – August 2010

Analysis and Forecasts: Westpac Property

- As expected, demand in Adelaide's CBD (Core and Frame) strengthened over 1H 2010, driven by an improvement in employment confidence. Adelaide CBD recorded a net absorption of 13,074m² over 1H 2010, an improvement on the 2,228m² that was recorded for 2H 2009.
- Despite the improvement in demand, it was not enough to match supply, with 14,405m² completing in 1H 2010. This resulted in the vacancy rate rising from 7.6% in January to a current 8.1%. Vacancy remains below the 10-year average of 8.5%
- Vacancy is now likely to have peaked, with demand expected to outstrip supply over the forecast period. As such, vacancy is forecast to decline to 7.1% by years end before falling further to 6.1% by the end of 2011 and 5.9% by the end of 2012. Forecast vacancy is similar to what we were expecting in our January Outlook publication

Rental growth to accelerate from 2011 as vacancy rates drop

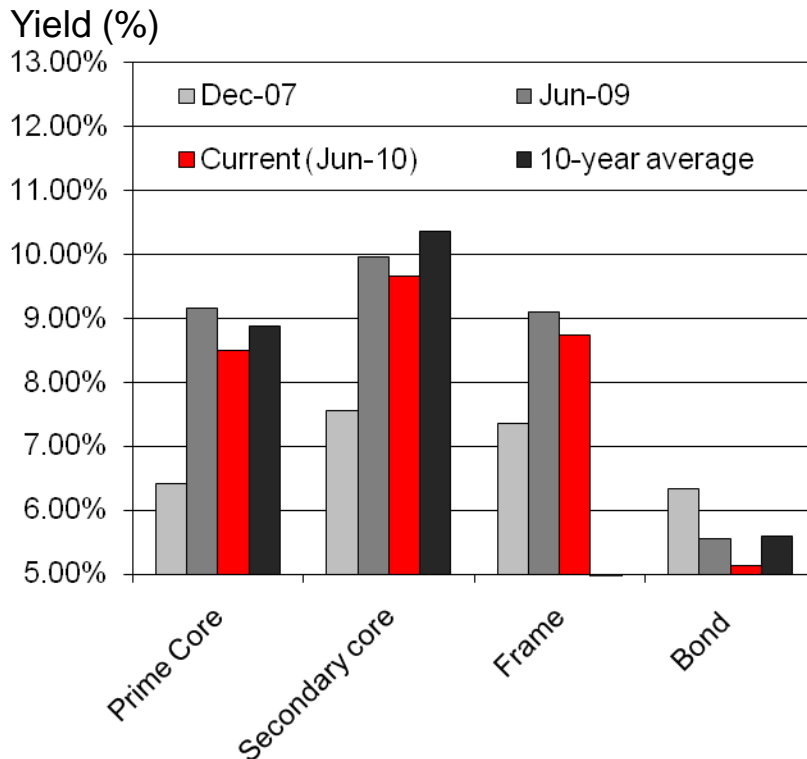
Net effective rents – Adelaide Core (Prime)



- Net effective rents in Adelaide's Core performed as expected over 1H 2010. Rents remained stable in the 6 months to June as vacancy rose further. Annually, prime rents are higher than a year ago by 2.5% while secondary rents are 2.0% higher.
- With demand expected to exceed supply, leading to lower vacancy rates, we maintain the view that rental growth is likely to remain positive over the forecast period.
- Expectations are for growth of around 2.5% over 2H 2010 before accelerating in 2011 and 2012 to around 6-7% annually as vacancy levels fall. We maintain the view that growth is likely to remain driven primarily by face rents as incentives are currently below long-term levels.

Yields continue to firm

Adelaide office yields



Raw Data: CB Richard Ellis PTY Ltd

Analysis: Westpac Property

- In our previous publication, we indicated that yields would likely remain stable over 1H 2010. This did not occur as yields continued to firm, despite rents remaining stable and vacancy rising.
- Prime Core yields firmed by some 15bps over 1H 2010 to 8.50% and are 65bps lower than a year ago. Secondary Core yields firmed by some 20bps over 1H 2010 to 9.65% and are 30bps lower than a year ago. Yields in Adelaide's Frame firmed by some 20bps over 1H 2010 to 8.75% and are 40bps lower than a year ago.
- In our last publication we flagged that while Core yields remain below their 10-year averages, the improvement in stock may mean that average yield levels are no longer a sufficient gauge in determining where the equilibrium yield is. While we continue to question this, we now consider that yields have firmed prematurely and are likely to remain stable into 2011.



Outlook for Australian Property Markets 2010-2012

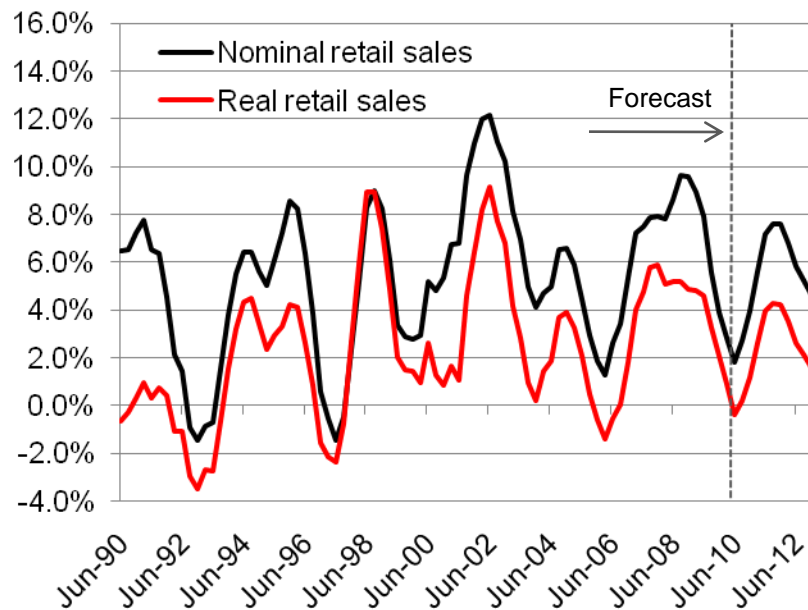
Adelaide Retail

Update August 2010

Retail sales to grow at above average levels in 2H 2010, but slow thereafter...

Retail sales growth annual change - SA

Growth (annual)



- Similarly to the national trend, retail sales in South Australia have been volatile over 1H 2010, particularly in recent months. While nominal sales grew at an above trend of 2.0% over Q2, the entire growth occurred in April. May and June recorded falls of -0.4% and -0.7% respectively.
- Despite the weakness, Access Economics have upgraded their outlook for Adelaide's retail sales since our last report. Expectations are for nominal retail sales to pick up to around the average rate of 1.6% in Q3 and Q4 2010 before trending above average over 1H 2011.
- Nominal retail sales are expected to slow back to below average levels from 2H 2011 as population growth slows and employment growth falls to just below average from late 2011.

Source: ABS

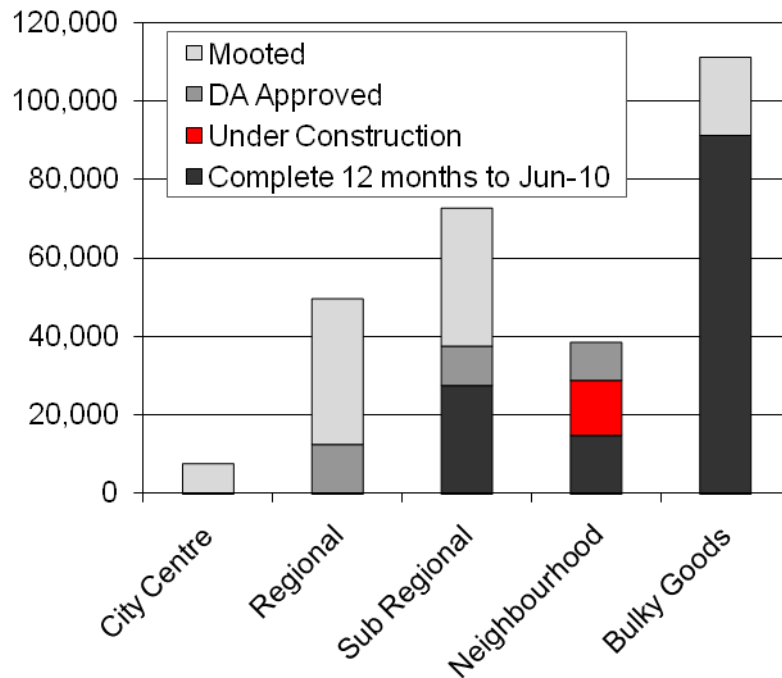
Forecast: Access Economics

Analysis: Westpac Property

Retail space under construction is low, however keep a watch on mooted supply...

Retail supply - Adelaide

Square metres



- Retail supply levels were reasonably high over the 12 months to June, with some 133,630m² completing. The completion of the 58,345m² Home HQ at Gepps Cross in Q3 2009 accounted for 44% of the completed retail space.
- Retail supply levels are expected to be substantially lower through to the end of our forecast period in 2012. According to CBRE, there are only two neighbourhood shopping centres under construction in Adelaide, which will add a further 13,900m² to the market in 2H 2010. A possible 32,500m² of supply with a DA may also come online in 2011/12.
- Some 20,000m² of projects have a DA, while a further 79,800m² is on hold. Mooted supply is spread across most centre types. Supply levels are not overly concerning at this point, but expectations of slowing sales growth mean future supply starts should be monitored.

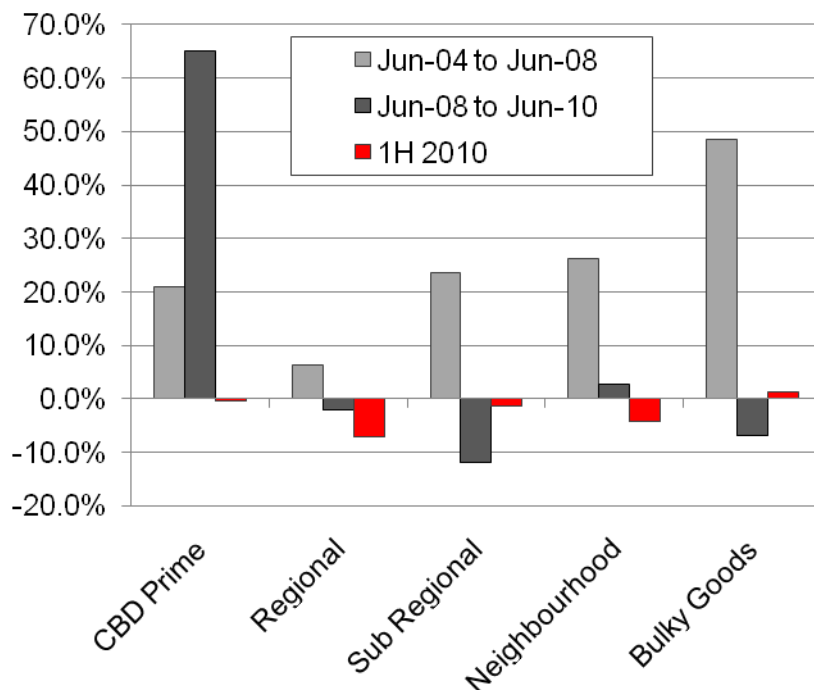
Source: CB Richard Ellis Pty Ltd

Analysis: Westpac Property

Moderate rental growth is likely over the next 12 months as retail sales pick up

Retail rental growth – Adelaide

Growth



- As expected, retail rents in Adelaide remained weak over 1H 2010. Retail rents declined over 1H 2010, with falls ranging between -0.3% in city centres to -7.2% in regional centres. The exception was bulky goods centres, which recorded an increase of 1.2% over 1H 2010.
- Despite the 6 monthly decline, rents appear to have stabilised in Q2 2010 across most centre types. Bulky goods centres were the only centre type to record an increase over Q2, growing by 1.4%.
- Retail sales are forecast to grow at around average levels over 2H 2010 and at above average levels in 1H 2011. As such the fall in rents to 2010 may correct over the next 12 months, before stabilising.

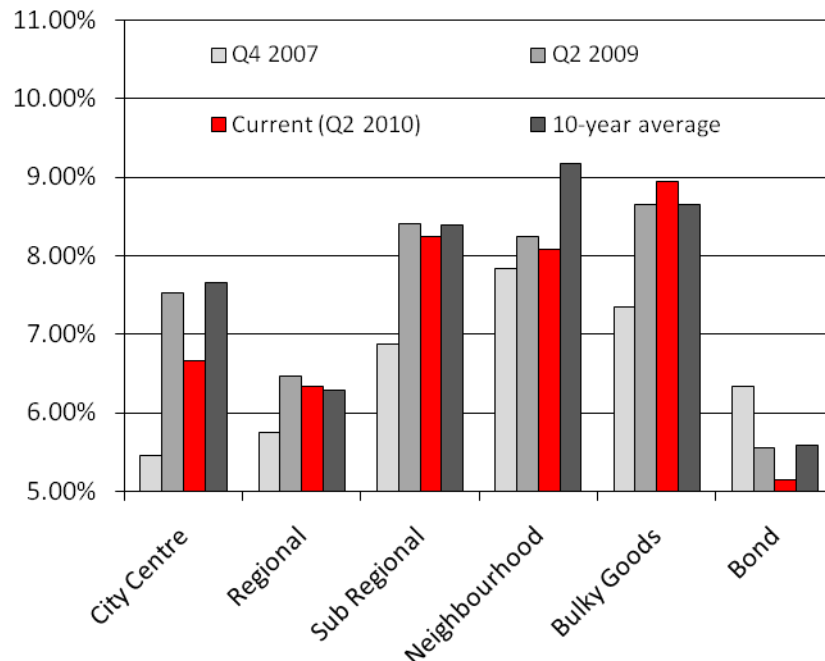
Source: CBRE

Analysis: Westpac Property

Retail yields may firm over the next 12 months as retail sales and rents pick up

Retail shopping centre yields - Adelaide

Yield



Source: CB Richard Ellis Pty Ltd

Analysis: Westpac Property

- Retail yields in Adelaide stabilised across most centre types over 1H 2010. City centres and bulky goods centres were the exception, easing by a further 15bps and 40bps over 1H 2010, respectively.
- Retail yields in Adelaide are now some 25bps (neighbourhood) to 160bps (bulky goods) higher than their peak levels in Q4 2007.
- Since peaking, retail yields in Adelaide have not eased as much as in other capital cities and remain below their 10-year averages levels. However, on a yield basis they do not appear to be out of line when compared to national levels.
- Westpac Property maintain the view that while analytically it appears as though yields need to ease further in comparison to their average levels, it is more likely that minimal firming may occur over the next 12 months as rents pick up. Stabilisation should again occur from mid 2011 as retail sales growth and rental growth eases.



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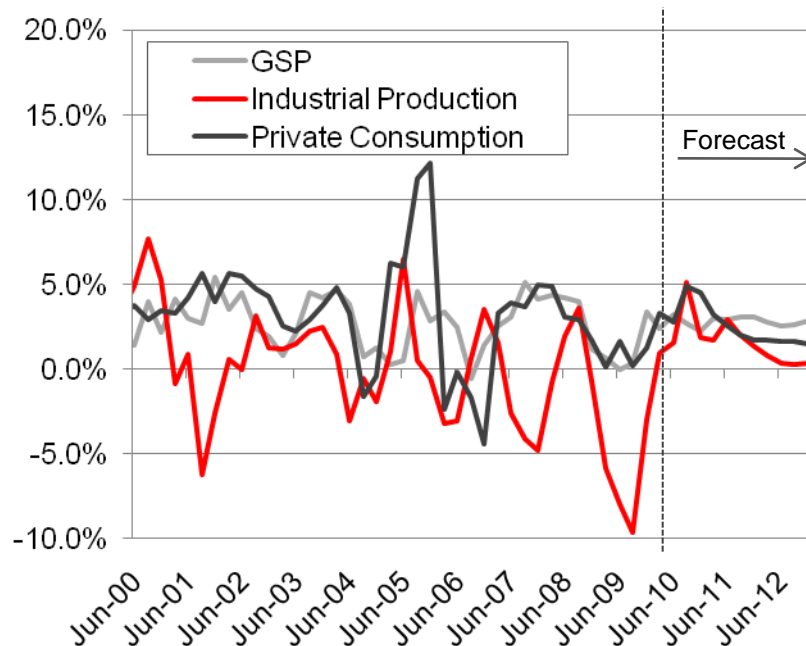
Adelaide Industrial

Update August 2010

Demand to improve into 2011 as industrial indicators strengthen...

State economy indicators – SA

Annual Change (%)



- Estimated annual GSP for SA increased by 2.4% in March. Forecasts are for steady growth over the forecast period at around 2.8% per annum .
- Industrial production started to pick up in 1H 2010 after remaining weak for much of the last 2 years. Access Economics suggest a pick-up to above average levels in 2010 and 2011 before slowing in 2012.
- As demand indicators pick up to above average levels from late 2010 through to 2011, demand for industrial property should follow suit. However as growth levels slow to around average levels over 2012, demand, while remaining positive, is also likely to pull back.

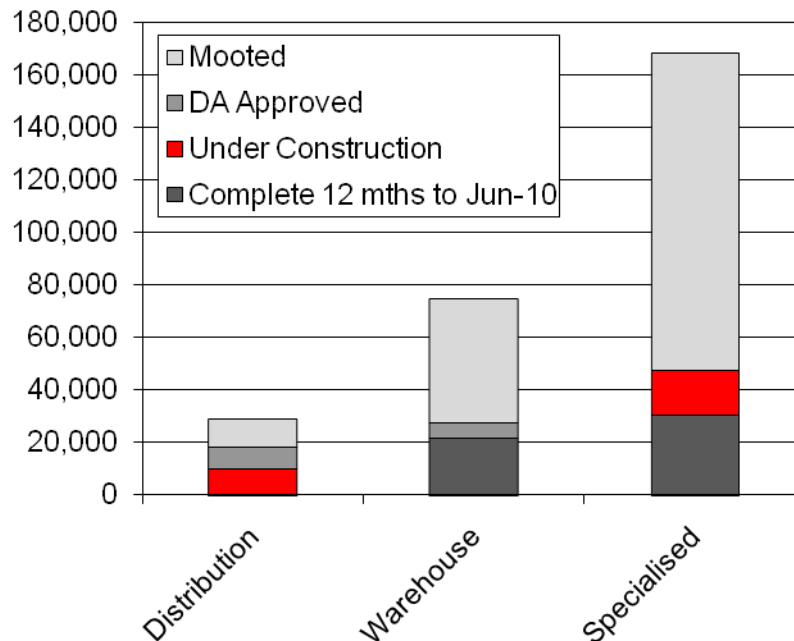
Source: Access Economics

Analysis: Westpac Property

Industrial supply levels remain low and are of no real concern...

Industrial supply - Adelaide

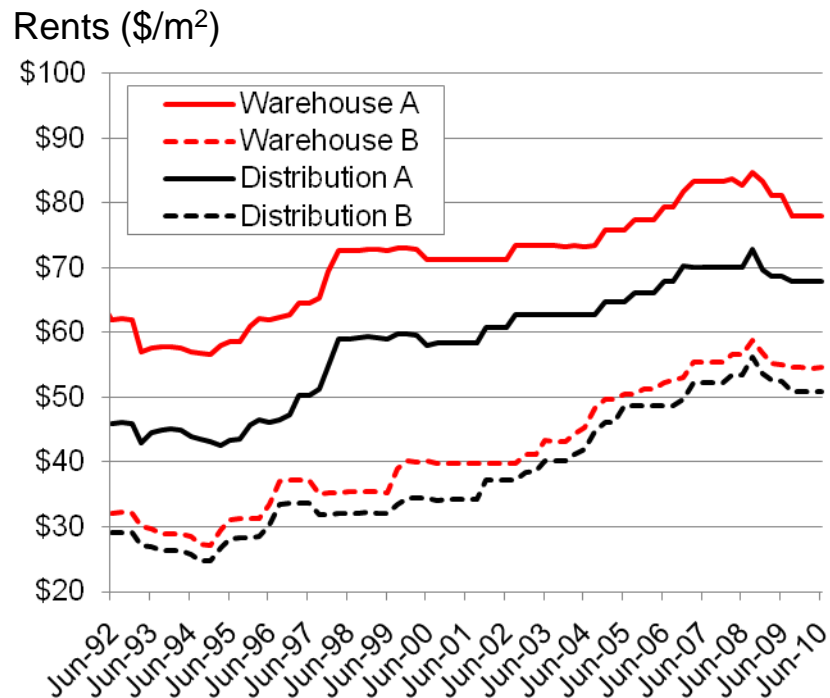
Square metres



- In the 12 months to June, some 52,500m² of industrial supply was completed in Adelaide's industrial market. Of the annual supply, 32,200m² was completed in 1H 2010.
- The supply pipeline over 2H 2010 will slow slightly in comparison to 1H 2010, as the 27,000m² currently under construction completes.
- With some 14,500m² of projects having a DA, plus a further 60,000m² having submitted DA's for approval supply levels in 2011 should remain similar to that of the last 12 months. We maintain our view that supply levels over the forecast period are of no concern.
- Of the 118,670m² of mooted supply, 81,000m² is marked as a specialised naval ship building facility due beyond 2012.

Improving demand likely to lead to higher rents over 2H 2010...

Industrial net effective rents - Adelaide



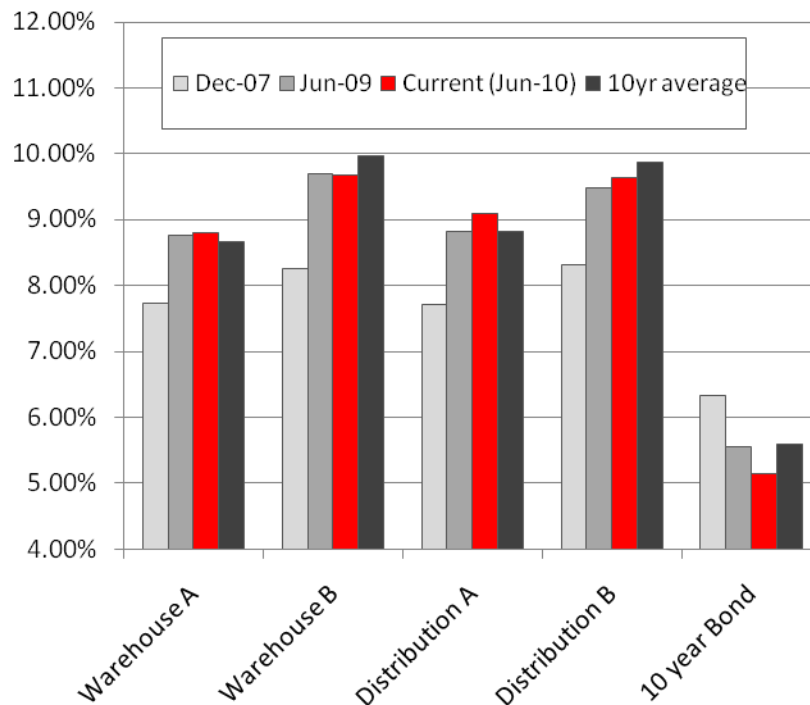
- As expected, industrial rents in Adelaide stabilised over 1H 2010. Industrial rents in Adelaide remain some -6.7% (distribution A) to -9.0% (distribution B) below peak levels of Q3 2008.
- With demand indicator forecasts suggesting above average growth from late 2010, resulting in improving demand, pressure should increase on rents into 2011. We have however upgraded our previous expectations of growth to be at or below CPI to now slightly above CPI as a result of low supply and improved economic outlook. Growth should be strongest in prime properties.
- Rents are likely to stabilise from early 2012 as a result of slower demand.

Source: CBRE

Yields to firm over 2011 as income potential picks up...

Industrial yields - Adelaide

Yield (%)



- Industrial yields in Adelaide recorded mixed results over 1H 2010. Yields for the warehouse sector firmed marginally, by -5bps to 9.70% for secondary warehouse and -15bps to 8.80% for prime warehouses.
- This is likely a correctional move, considering prime warehouse yields remain above the 10-year average. Similarly the current risk premium to the 10-year bond rate is also above average levels by 60bps. The firming in secondary warehouse is surprising given that the current yield remains below its 10-year average. Yields for distribution centres remained stable over 1H 2010
- Industrial yields remain some 105bps (warehouse A) to 145bps (warehouse B) above the peak levels of Q4 2007.
- We maintain the view that a pick up in income from 2011 may result in some firming in yields from late 2010/ early 2011, albeit at a minimal rate.

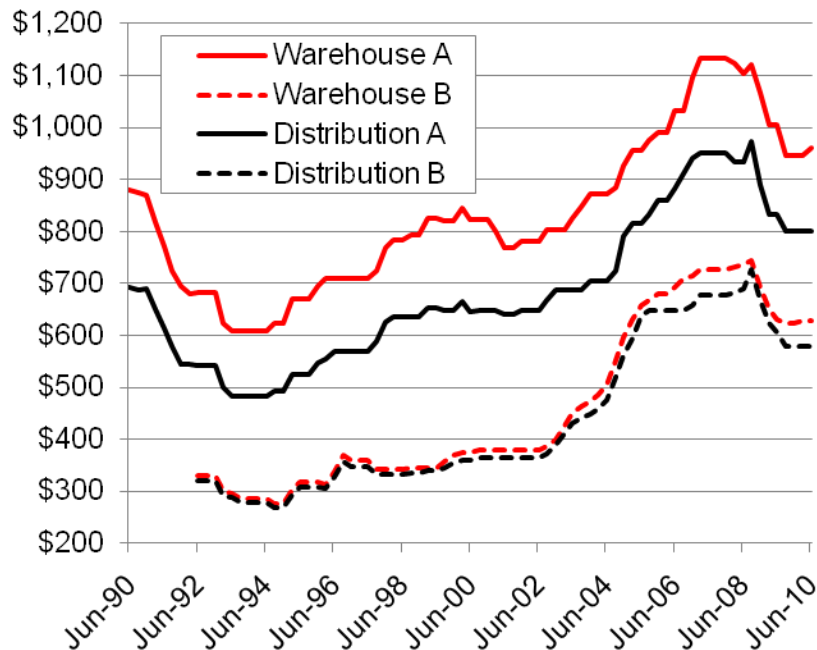
Source: CB Richard Ellis

Analysis: Westpac Property

Capital values to improve over 2011 as rents rise and yields firm.

Industrial capital values- Adelaide

Capital value(\$/m²)

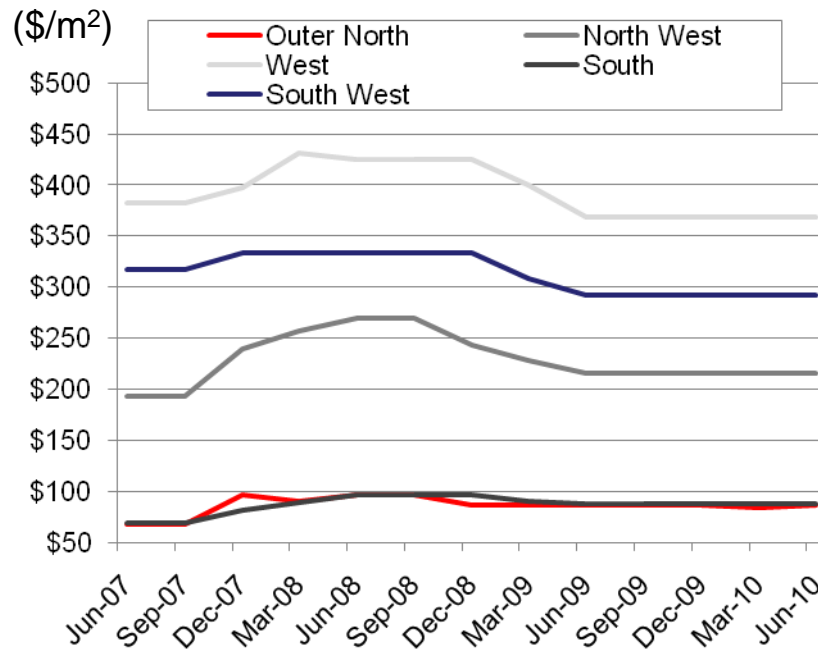


- As expected, capital values in Adelaide's industrial market remained largely stable over 1H 2010. The prime warehouse market was the exception, which recorded an increase in value, by 1.6%. The increase in value was driven by the firming of yields by 15bps in Q2. Capital values in all remaining sub-markets have remained stable since Q4 2009.
- Since peaking around mid 2008, capital values have declined by between 15% (warehouse) and 20% (distribution). Values are now back to around late 2004/early 2005 levels.
- Westpac Property are of the view that growth in capital values, is likely to occur from late 2010/early 2011 as yields firm and rents rise.
- As a result of our expectation for stable rents and yields from 2012, values are expected to follow suit beyond 2011.

Source: CBRE

A window of opportunity for land values to increase may arise over 2011

Average Industrial land values- Adelaide 0.25ha sites



- Industrial land values in Adelaide have remained stable since mid 2009 across all precincts.
- Since peaking in 2H 2008, industrial land values have declined by between -9% in Adelaide's south and -20% in Adelaide's north west.
- Industrial land values are likely to see minimal movement in the short term. Limited growth may emerge from 2H 2011 as rents improve, however the window of opportunity for upside potential is likely to be short lived.

Source: CBRE

Disclaimer

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