



Outlook for Australian Property Markets 2010-2012

Melbourne

Update August 2010



Outlook for Australian Property Markets 2010-2012

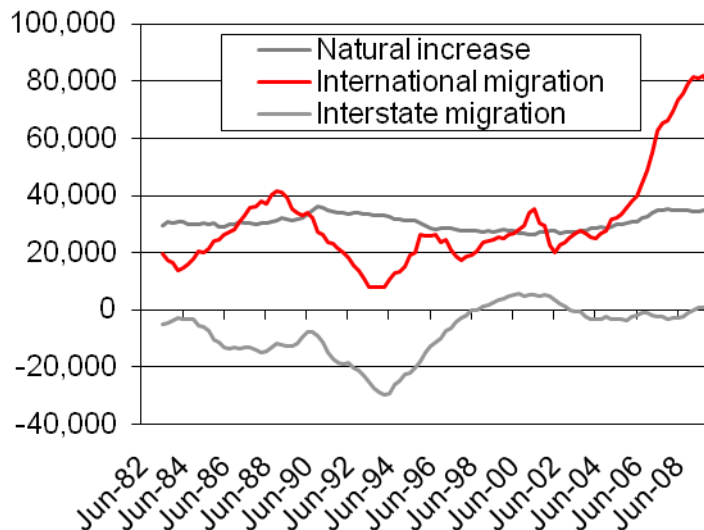
Melbourne Residential

Update August 2010

Population growth finally plateaus, but at high levels

Population growth - VIC

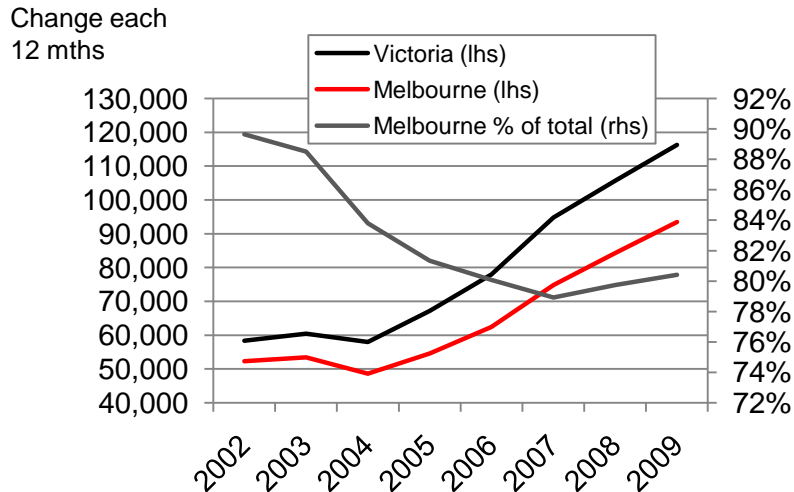
Growth - persons



- Although annual growth in population has finally peaked, it remained a healthy 114,000 people in the year to December 2009. Immigration was the key driver accounting for 70% of the growth.
- However, quarterly analysis reveals that immigration slowed in the second half of 2009 to 33,800, down from 43,700 in the first half. However, this remains well above figures in previous half years.
- The immigration is fuelling a need for more dwellings and helping boost economic growth. The risk to the markets are potentially tighter immigration laws and lower numbers should there be a change in Government.

With most of Victoria's population growth happening in Melbourne

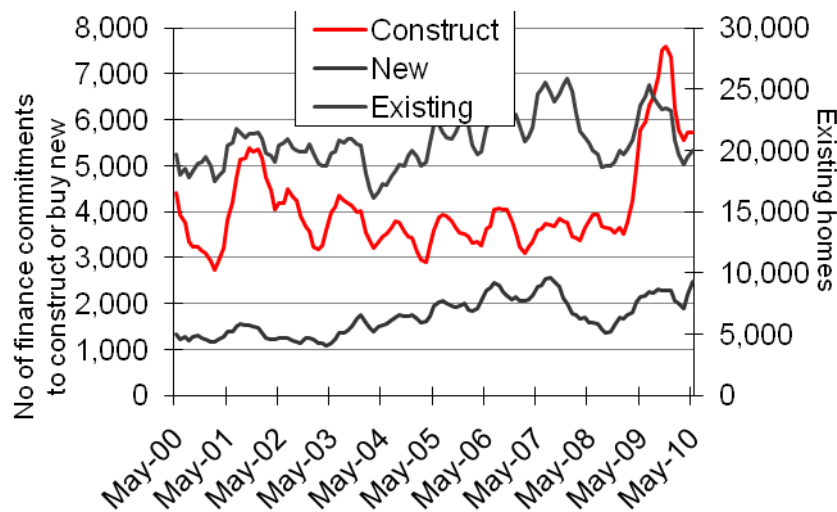
Population growth year to June - Melbourne and Victoria



- Victoria's strong population growth has largely been concentrated in the capital. Over the past seven years over 80% of the State's population growth has been concentrated in Melbourne .
- As expected at 80% of Victoria's population surge has meant more than 93,000 new residents has located in the City in the year to June 2009. With 33,800 population growth in 2H 2009, 80% would suggest a further 27,000 for Melbourne. This would take growth back to levels seen in the early to mid 2000s.
- The possibility of slower immigration, and thus slower population growth, needs to be monitored in Melbourne. Particularly with regard to the levels of dwelling approvals in some areas. While the still healthy population growth of 2H 2009 requires new dwellings, it is unlikely that the population trends of recent years will continue indefinitely.

Demand slows into early 2010, but remains high for new or construct.

Finance commitments to buy or construct new or to buy existing dwellings – Vic 3 monthly moving totals



Source: ABS

Analysis: Westpac Property

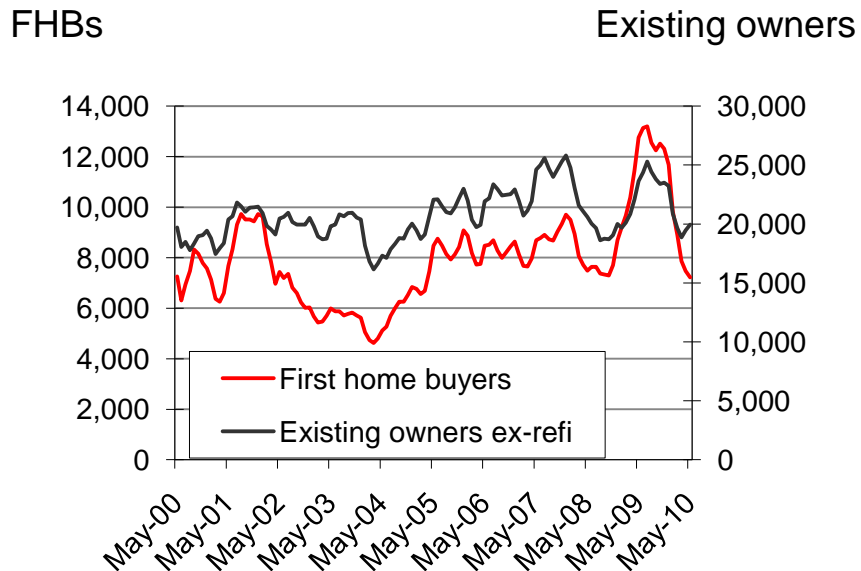
- The finance commitments to purchase property in Victoria slowed much faster than we had anticipated. This was despite the continued strong population growth to the end of 2009, which we felt would have provided demand into 2010. However, the rate of job growth slowed slightly and while remaining positive at 39,000 new jobs, was under half the total of 2H 2009. This may have affected confidence.
- Finance to construct or buy a new property remained active, despite a significant fall in finance to construct. Continued stimulus from the State government, replacing the Federal Governments FHB boost appears to have kept activity high.
- However, the larger existing market showed signs of falling back to just above 2008 lows.
- Signs of improving demand appeared in Q2.

Westpac

Australia's First Bank

First home buyers slow in 2010, limited upside, existing to return in 2H

FHBs vs. Existing owners – Victoria 3-month rolling



- Following a stronger than expected result in 2H 2009, first home buyer demand has crashed in Victoria. This is not unexpected and figures to May remain around levels of 2004 to 2008. It may be that State Government incentives to buy new houses have provided a floor, with the potential that FHBs fall further as the incentive is removed.
- Existing owners, as stated earlier fell further than expected, although are showing signs of a lift in Q2.
- Despite the Victoria Government's extension of the first home owners bonus to FHBs to purchase new property, the number of eligible participants must be getting weaker. The extent of the pull forward factor should ensure further weakness from this group into 2H 2010 and 2011.
- The expectation by WBC Economics of the low possibility of interest rate hikes in 2H 2010, plus continued economic improvement should aid demand for residential in 2H.

Source: ABS

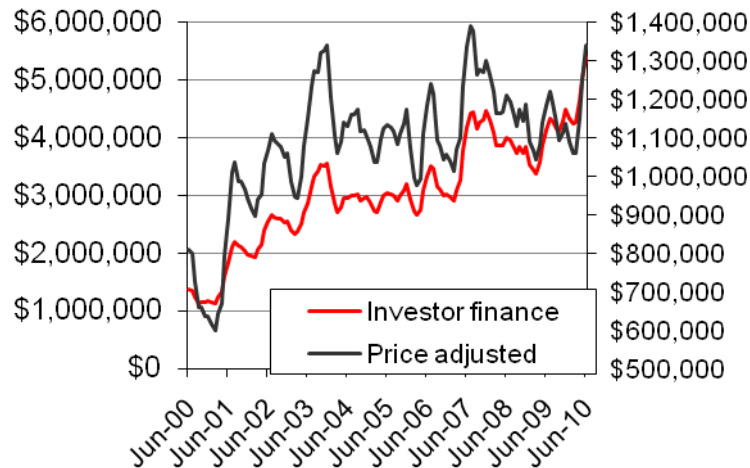
Analysis: Westpac Economics

Investors surge, some slowdown expected

Investor Finance - Vic

Investor finance

Price adjusted



- In February we forecast that *'given strong price growth in 2H 2009, strong population growth and continued improvement in the economy, investor activity should continue to improve into 2010.'*
- Investors surged in the Victorian market during the first half of the year. Growth of 20% in nominal terms but also 18% in price adjusted (as values stabilised) suggested the investor was attracted by the strong price growth of 2009, as expected.
- Although below the peak of mid 2007 the price adjusted investor confirms solid activity in this market, despite interest rate increases.
- With no further interest rate rises expected in 2010 and a number of projects completing over the next few years, the investment market should remain active.
- However, the biggest challenge will come from the consideration of potential price growth following the 20%+ achieved in 2009 and the slowdown occurring in 2010.

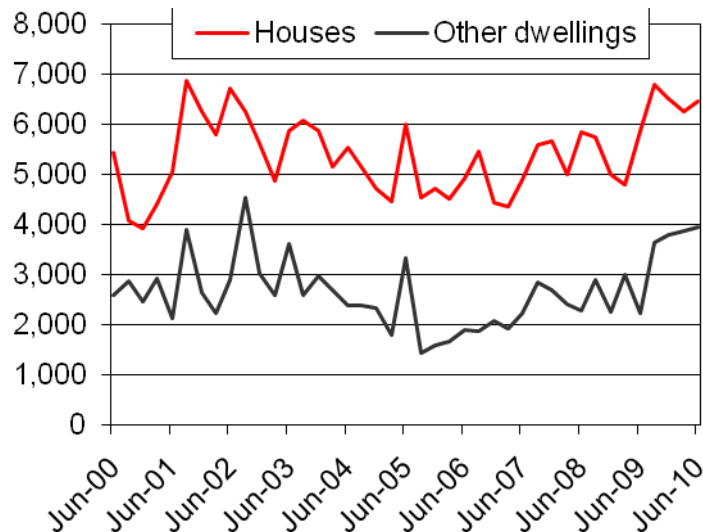
Source: ABS

Analysis: Westpac Economics

Approvals maintain high level, but would allow slower population growth

Dwelling approvals - Melbourne

Number



Source: ABS

Analysis: Westpac Property

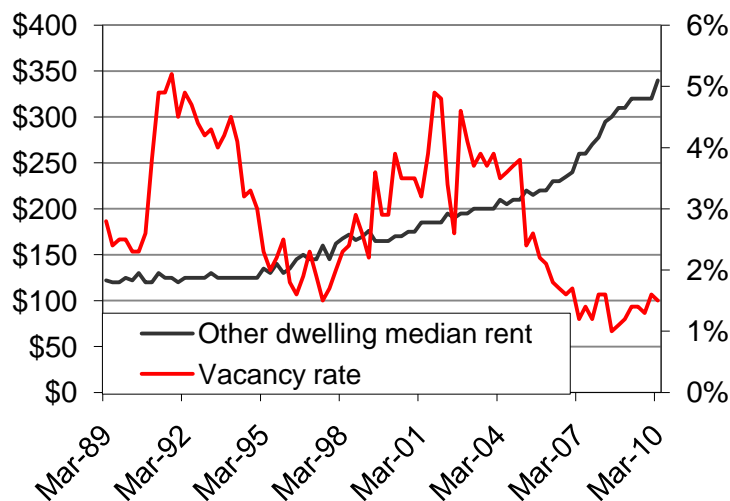
- As mentioned, Melbourne's population grew by over 93,000 in the year to June 2009. At 2.6 persons per dwelling this would generate a need for 35,770 new dwellings, excluding demolitions. In the year to June 2009 approvals amounted to 31,880, suggesting an undersupply.
- In the year to June 2010 approvals have soared to 41,324, with numbers accelerating in Q3 2009 and holding for the final three quarters of the financial year. Allowing for the fact that not all approvals commence and a standard demolition factor of around 0.6% of total stock, population growth could slow to just over 82,100 to meet new net supply. This would need a slowdown in population growth to 2007 levels.
- However, changes in student visas, considerations of slowing immigration and soaring prices suggest that supply levels need to be monitored in Melbourne. While any oversupply may help reduce the undersupply inherited from recent years, it could also have an impact of slowing price growth.

Rents lift Q1, further increases likely

Melbourne rent and vacancy

Rent per week

Vacancy rate



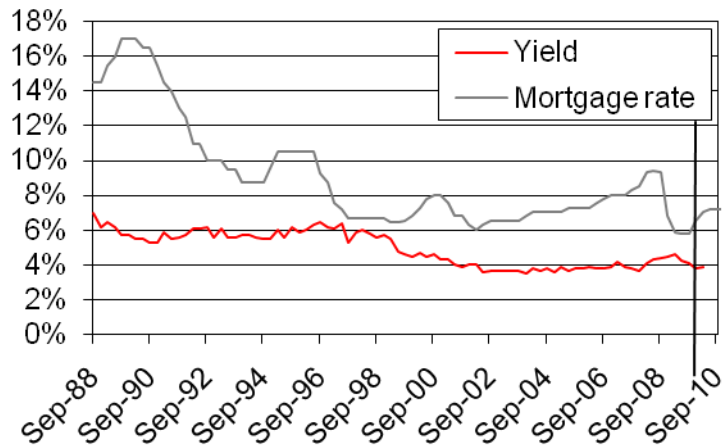
Source: REIA

- A surge in completions in Q4 2009 led to vacancy lifting to 1.6% in December, before falling marginally to 1.5% in Q1 2010.
- We suggested in February that *landlords would be able to start lifting rents as the FHB boost ended and interest rates were rising, although mostly in 2H 2010, when the State's own FHB incentives ended.* In the March quarter rents rose by a stronger than expected 6.3%. However, the State has now extended the FHB boost to mid 2011
- Despite the increase, Victoria remains one of the most affordable States in the country in which to rent, at 22.6% of household income. This is only slightly up on September's figures. However, as the proportion of income needed to service a mortgage has risen to 32.6% in March and further as rates rose in April and May, rents are likely to rise further over the next year to 18 months.

Yields fell below 4% in 2010, to start lifting from 2H 2010

Yield (2 bedroom other dwelling) and mortgage rate - Melbourne

Yield/rate



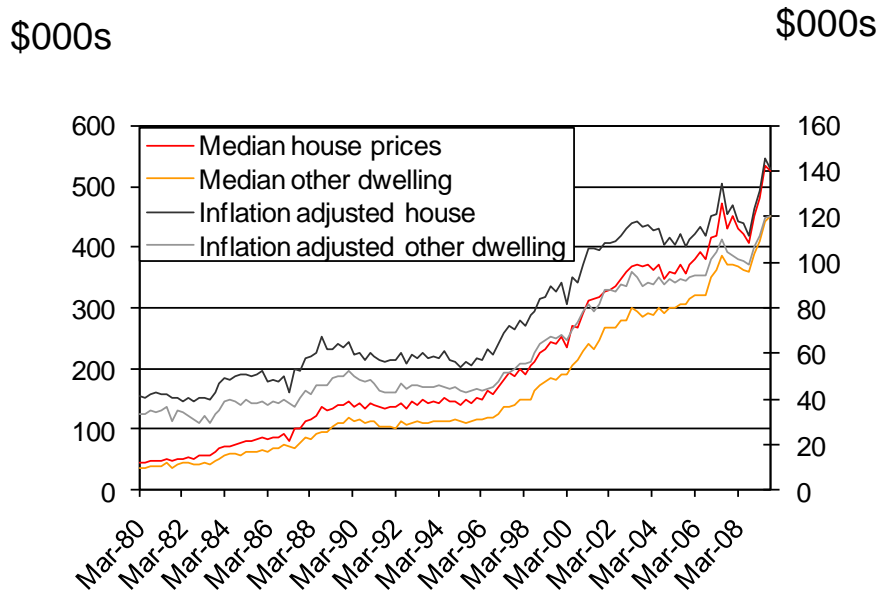
- Our expectations of falling yields in 1H 2010 was correct, with yields falling to 3.9% in Q1.
- The potential for and likelihood of higher rents through 2010 and into 2011 should drive yields higher from 2H 2010.
- Rising interest rates, higher debt and continued low vacancy should be the drivers for higher rents.
- In February we forecast yields of 4% by year end. We now forecast yields to rise to 4.2% by year end and to continue to rise from there. This would suggest rental of \$360 per week, which would still have Melbourne as one of the least expensive cities to rent a 2 bedroom other dwelling.
- Similarly at 4.2%, Melbourne's yields would be amongst the lowest in the country.

Source: REIA, RBA

Forecasts: Westpac Property

Price growth flattening out as expected

Melbourne house and unit prices



Source: REIA

Westpac Property analysis

- Strong price growth evident in mid 2009 had continued into Q4 as thought in February, before data was released. The extent was greater than expected at 11% for houses and 8% for other dwellings in the quarter
- Also as expected this rate of growth was unsustainable and slowed in Q1. Median house prices actually fell by 2% in the quarter, while other dwellings rose by 2%.
- Further price growth slowing is expected for the remainder of 2010 and into 2011. Despite a healthier economy, interest rate hikes in Q2 2010 and expected further rises in 2011, should keep a lid on price growth for the short term. There is a potential for some pressure on prices in 2H 2010 as interest rates stabilise, although with a 29% increase in houses and 25% rise in other dwelling prices in the previous 12 months a period of stability is more likely.

Westpac

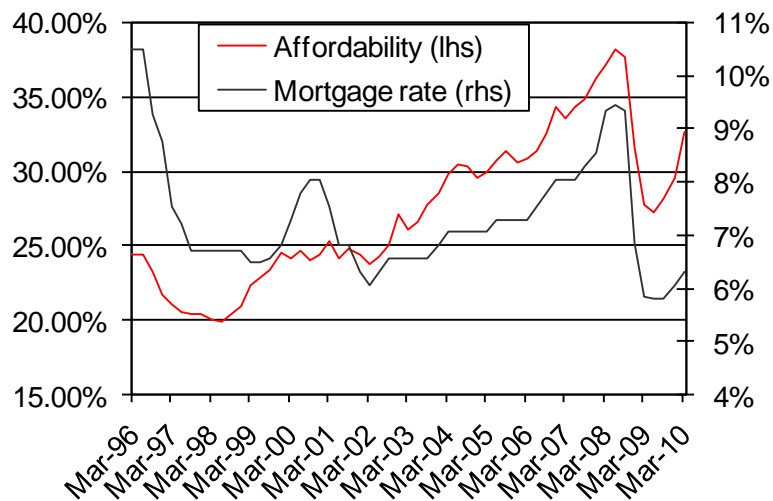
Australia's First Bank

Affordability rises to above average, which should slow price gains

Affordability and mortgage rate - Melbourne

Household income allocated to mortgage (%)

Mortgage rate



- The strong price increase in Q4 and continued interest rate rises into Q1 2010 have lifted the proportion of household income needed to service an average mortgage to 32.6% in Q1 2010. While significantly above the 27.3% of a year earlier, it remains well below the 38% peak of 2008.
- Further interest rate rises will have pushed the figure up to close to 34% by mid year, allowing for no change in loan size.
- Average household income rose by 5.8% in Victoria in the year to Q1 2010. If this rate of growth continued, average prices could rise by 2.5% to end 2010 without changing the proportion needed to service the loan.
- Average affordability over the five years to Q1 2010 was 32.8% of household income, while the 10 year average falls to 29.4%

Source: REIA and RBA



Outlook for Australian Property Markets 2010-2012

Melbourne Offices

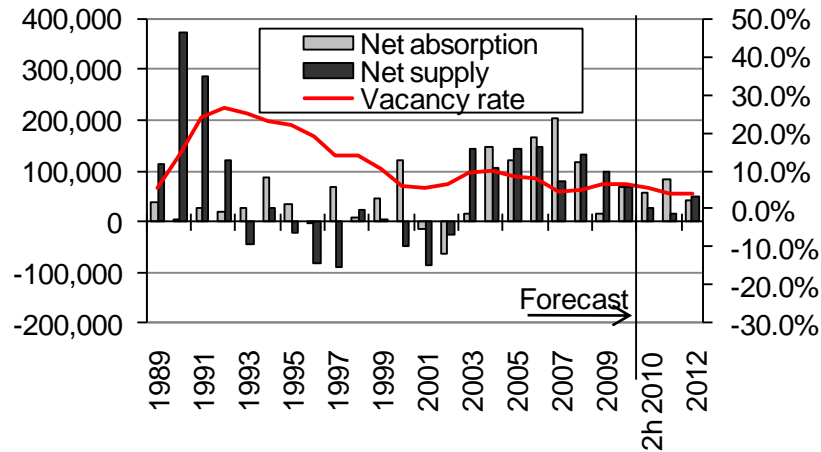
Update August 2010

Melbourne CBD Office market development cycle winding down, to start again soon

Net absorption, net supply and vacancy – Melbourne CBD

Square metres

Vacancy Rate



- Completions amounting to 74,500 square metres were almost matched by (once again) surprisingly strong net absorption. As such, vacancy remained largely unchanged at 6.5% by mid year, down from 6.6% at year start as stock was withdrawn for refurbishment.
- As mentioned in February, a low level of new starts in 2009 and completion of properties in the latest cycle means fewer properties under construction. As at June only 94,000 square metres was under construction. While a significant 216,700 square metres has development approval and some are likely to commence with pre-commitment, much of this stock will complete post 2012.
- Having forecast a continued out performance in terms of demand in our February forecast, little has changed in vacancy forecasts from then. We continue to predict vacancy to fall to 4% by end 2011. However, given the success of Melbourne we also expect the next phase of the development cycle to be gathering pace in 2013/14

Source: Historical data: PCA OMR – July 2010

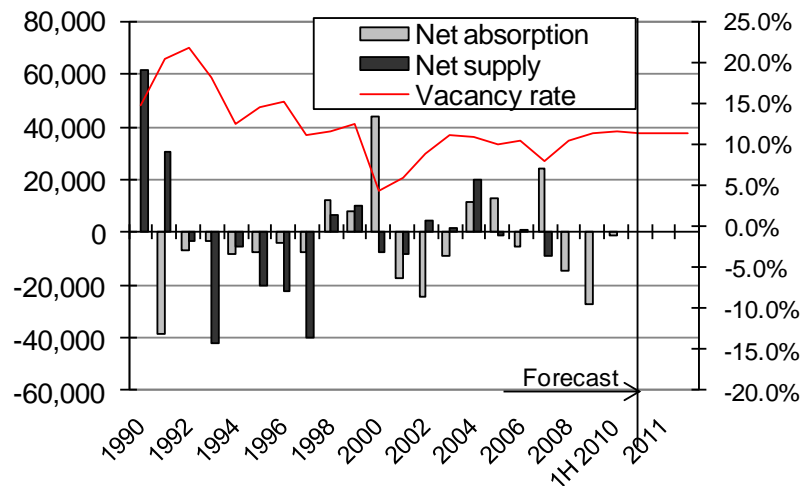
Forecasts: Westpac Property

St Kilda Road Office market slow death continues

Net absorption, net supply and vacancy – St Kilda Road

Square metres

Vacancy Rate



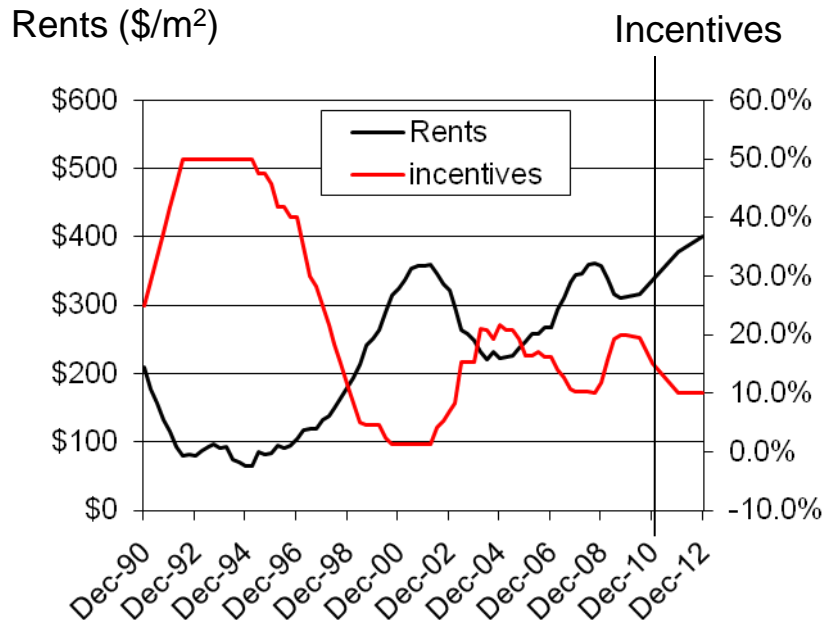
- While the CBD continues to out perform, St Kilda Road continues to move slowly backwards. Although there is nothing under construction and few are willing to invest in upgrading properties, negative net absorption of 1,425 square metres pushed vacancy up to 11.5% from 11.3% at year start.
- Forecasts for employment remain positive for Victoria and Melbourne in general, but with the exception of luring a tenant from the CBD, it is difficult to predict from where any recovery is going to be generated. With A grade vacancy of almost 12% and rents at around 60% of prime CBD, it is a question of what can be done to make St Kilda more attractive to prospective tenants.

Source: Historical data: PCA OMR – July 2010

Forecasts: Westpac Property

Melbourne CBD prime office market rents to surge in 2011 and 2012.

Prime net effective rents & incentives - Melbourne CBD



- Melbourne CBD prime office rents rose by 2.6% in 1H 2010. Incentives remained relatively stable at 20%. St Kilda Road prime rents fell by over 3% in 1H 2010 as incentives rose to 20%.
- As in February we continue to forecast CBD vacancy to fall to around 5% by the end of 2010 and incentives to fall to around 15%. This would generate effective rental growth of 8% for the year. However, growth should accelerate to 12% in 2011 as incentive falls to 10% and face rents rise.
- St Kilda Road rents could well fall further as landlords look to attract tenants.

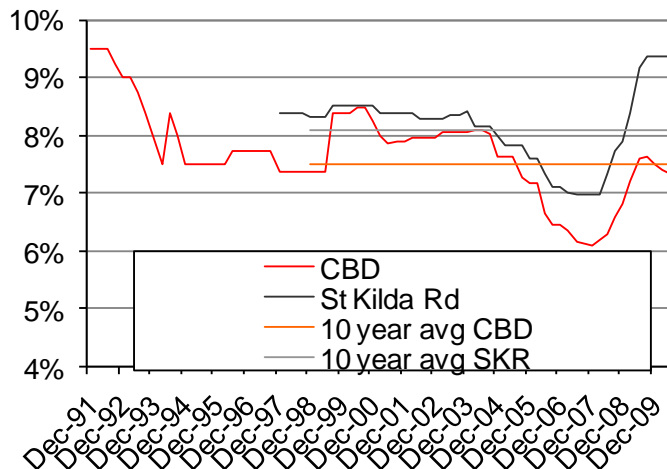
Source: CB Richard Ellis historic data to June 2010

Forecast: Westpac Property

Melbourne CBD prime office market yields fall below 10 year average

Office yields and 10 year average - Melbourne

Yield



- Melbourne CBD's success has attracted investors and resulted in yields firming by around 16 basis points since the start of the year. While still attractive at 7.34%, particularly when considering the potential total return if rental growth is achieved, yields have now fallen below their 10 year average. Despite this, investment focus is likely to intensify on Melbourne and further yield contraction should not be ruled out in 2H 2010 or 2011. While a return to the lows of 2007 are unlikely in the forecast period, sub 7% could well be achieved in 2011.
- St Kilda Road yields remained unchanged at 9.4%, well above average and reflecting the risk of limited income growth. Little change is expected by 2012.

Source: CB Richard Ellis historic data to June 2010

Forecast: Westpac Property



**Outlook for Australian
Property Markets 2010-2012**

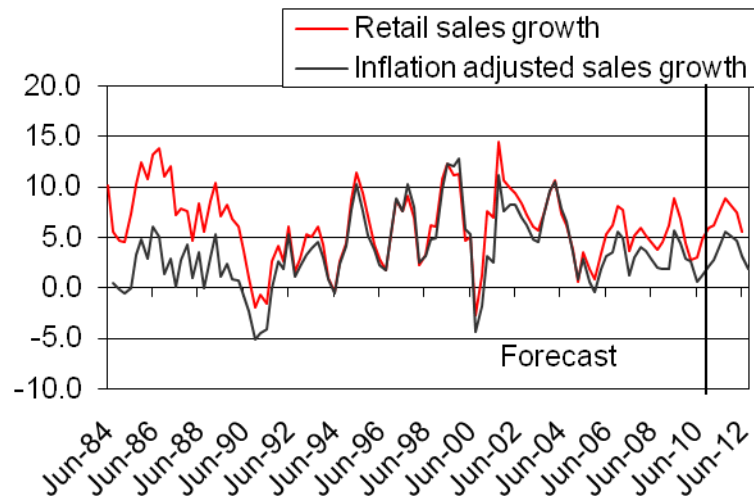
Melbourne Retail

Update August 2010

Retail sales growth to stabilise at below average levels

Change in retail sales - Victoria

Change on same qtr in previous year (%)



- The removal of stimulus in the form of low interest rates and government cash handouts, has impacted on Victoria's retail spending. June quarter spending was 3% higher than a year earlier, which given the gradual removal of stimulus, could be considered a healthy result. It was also the second highest growth rate in the country, behind Northern Territory
- Access Economics have lifted their expectations for spending in 2H 2010 and into 2011, with a full year 6% anticipated for 2010 and over 8% for 2012. They expect sales to slow to around 4% in 2012.
- The continued outperformance of the Victorian economy, plus above national average sales growth should ensure continued tenant demand for retail in this State.

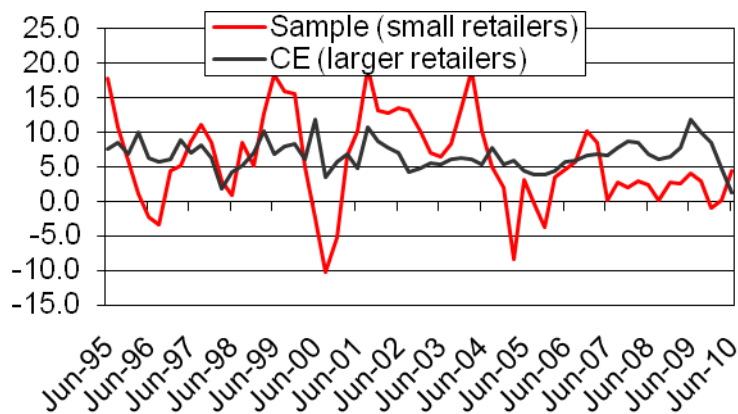
Source: ABS

Forecast: Access Economics

Victoria's larger retailers most impacted by stimulus withdrawal

Change in retail sales - Victoria

Change on same qtr in previous year (%)



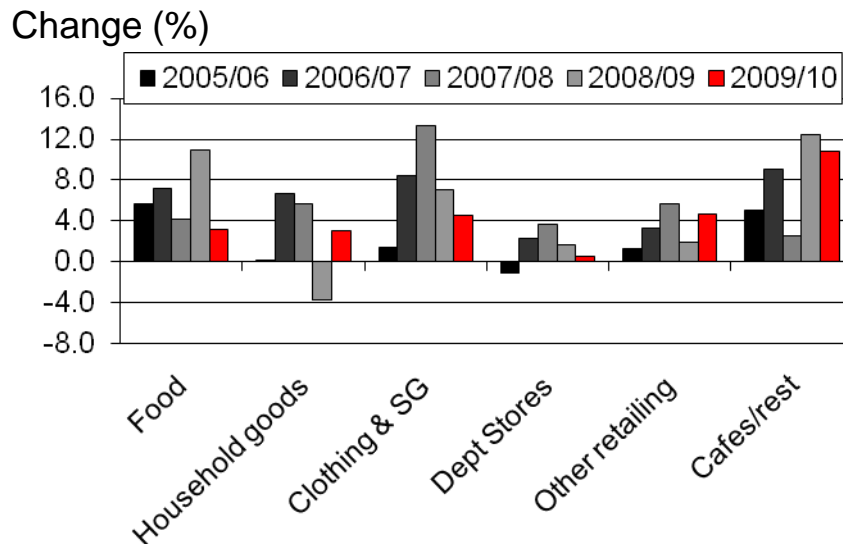
- The breakdown of retail spending by smaller retailers, where the ABS takes a sample of retailers, and larger retailers who are completely enumerated (CE), the past year to June 2010.
- As with other States, smaller retailers that appeared to be struggling during the GFC showed the strongest growth in the year to June 2010, at 4.4%.
- Conversely, it appears as if the larger retailers have been most impacted by the withdrawal of stimulus, with growth of just 1.25% in the year to June 2010.
- Both sectors should increase in 2H 2010, with the smaller retailers growth curbed by the rising interest rates in 2011.

Source: ABS

Forecast: Access Economics

Spending on food retains stable growth rate; department stores and other retailing the slowest

Annual change in retail spending by sector - Victoria



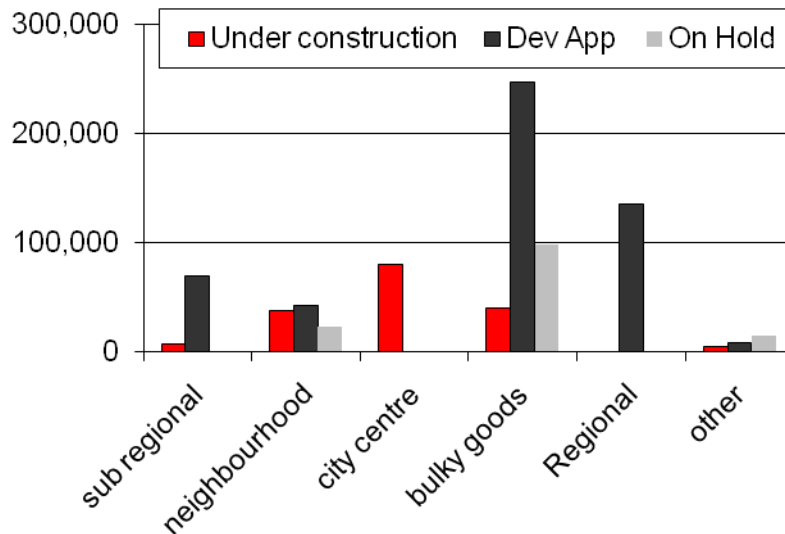
Source: ABS

- All sectors have shown rising sales in the past year. In particular the cafes and restaurant sector, which delivered another year of double digit growth. However, in 2009/10 this was driven solely by the take away food sector, as cafes and restaurants turnover fell.
- As expected household Goods retailing showed a recovery from the fall in 2008/9. With new residential supply due into 2011 this sector should continue to grow.
- Clothing and soft goods and other retail also performed well in the year.
- However, department stores continue to deliver weak sales growth in Victoria. The opening of the new stores in the CBD should help future sales

Short term supply appears low, but potential is high, particularly in bulky goods

Future retail supply - Melbourne

Square metres



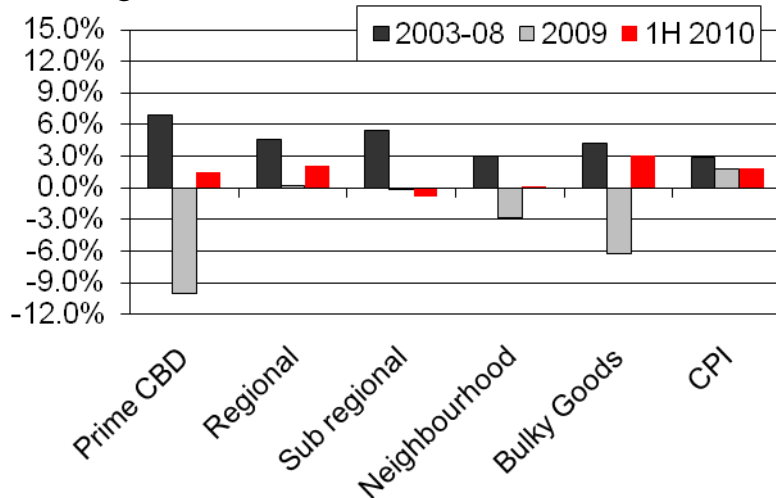
Source: CB Richard Ellis

- There are some 171,000 square metres of retail space under construction in Melbourne. This is steady from the start of the year. Almost half of this space is in the Myer Store redevelopment in the CBD, due for completion in 2012.
- The remainder of construction is largely Bulky goods and neighbourhood shopping centres.
- Projects with a DA in place have risen from 380,000m² at year start to over 500,000 square metres in May. Bulky Goods centres account for almost half, with Regional and sub regional shopping centre expansions also planned.
- The level of supply under construction is not of concern, but new starts are likely if 8% sales growth is achieved next year.

Rents recovering slowly in 2010

Net effective rental growth - Melbourne

Annual growth rate



Source: CB Richard Ellis

Analysis: Westpac Property

- Following declines across the city in 2009, 1H 2010 has largely seen net effective rents rise. The exception has been sub regional shopping centres (down 0.8%).
- However, analysing around the recent slowdown reveals above inflation level rental growth in all types of retail.
- Slowest growth has been for neighbourhood shopping centres at 3% per annum between 2003 and 2008, with the decline in 2009 yet to be recovered.
- The strongest type of retail was prime CBD shopping centres at almost 7% per annum to 2008, although the 10% decline in 2009 slowed this annual rate to 3.8% for the six years to 2009.
- Low new supply and forecasts for rising turnover should help rents continue to rise through to 2011.

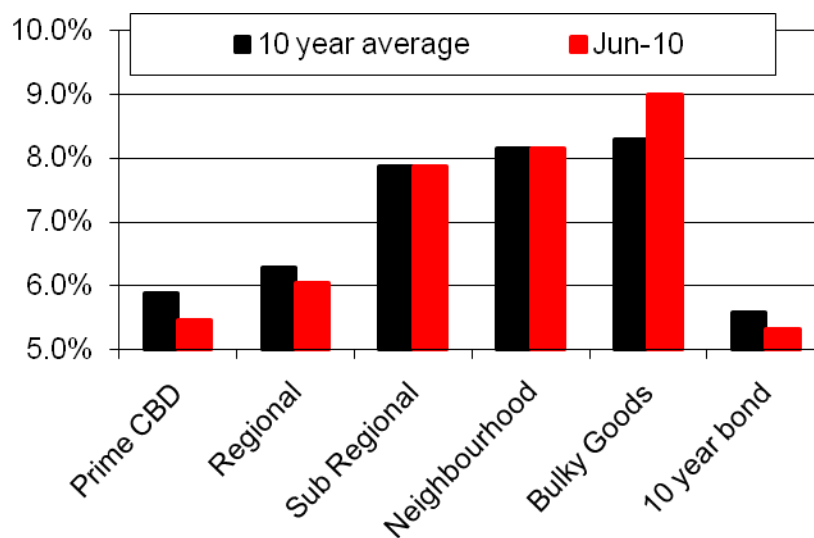


Australia's First Bank

Yields stabilise in 2010, firming likely into 2011

Retail yields - Melbourne

Yield



- As expected yields remained relatively stable in 1H 2010. Minor easing of up to 5 basis points was noted by CB Richard Ellis.
- Most yields are now close to longer term averages, the exceptions being bulky goods shopping centres, which are well over average and Prime CBD retail which are well under average.
- Improving retail sales growth should flow through to higher rents. The relative strength of Victoria's economy is attracting investor interest. This, combined with the favouritism for retail properties, could result in yields firming in either late 2010 or, more likely, into 2011.

Source: Raw data CB Richard Ellis and RBA

Analysis: Westpac Property



Outlook for Australian Property Markets 2010-2012

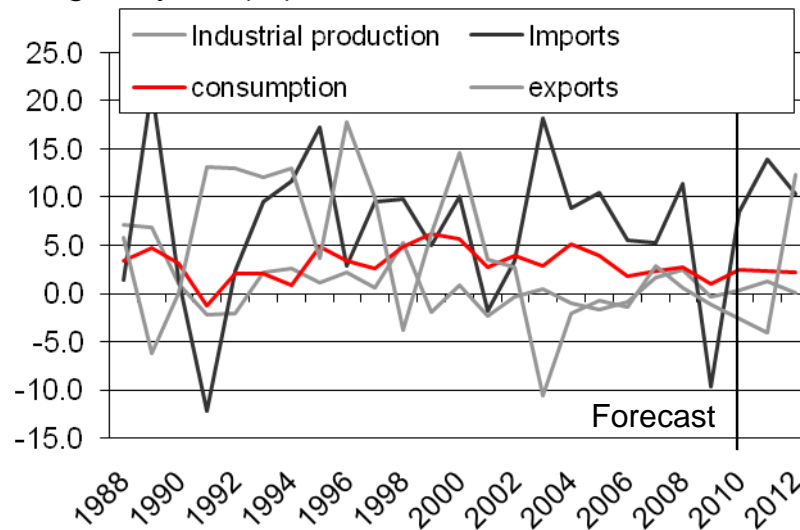
Melbourne Industrial

Update August 2010

Increasing demand for industrial space should occur as economy picks up

Consumption, industrial production, exports and imports - Vic

Change in year (%)

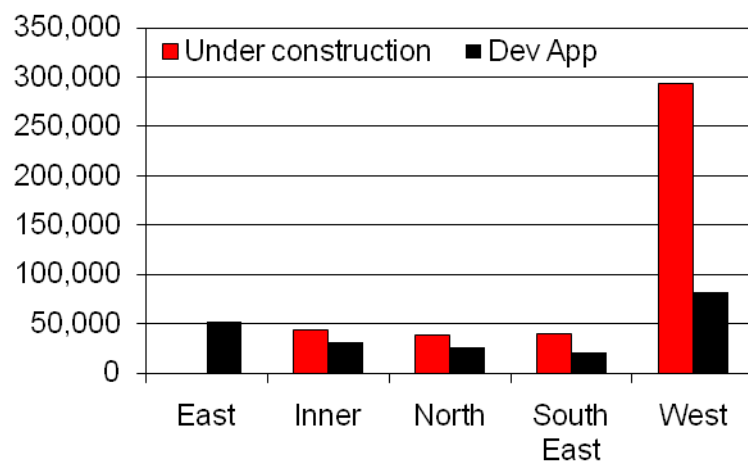


- The improving expectations for the Victorian economy should flow through to demand for industrial property.
- The weak expectation by Access Economics for industrial production, through to 2012, yet improving consumption, suggests the type of industrial property in demand will more likely be one involved in storage and distribution, than production.
- This is backed up by the strong expectations for growth in imports.

Supply under construction starts to lift, mostly in the West

Future industrial supply under construction - Melbourne

Square metres

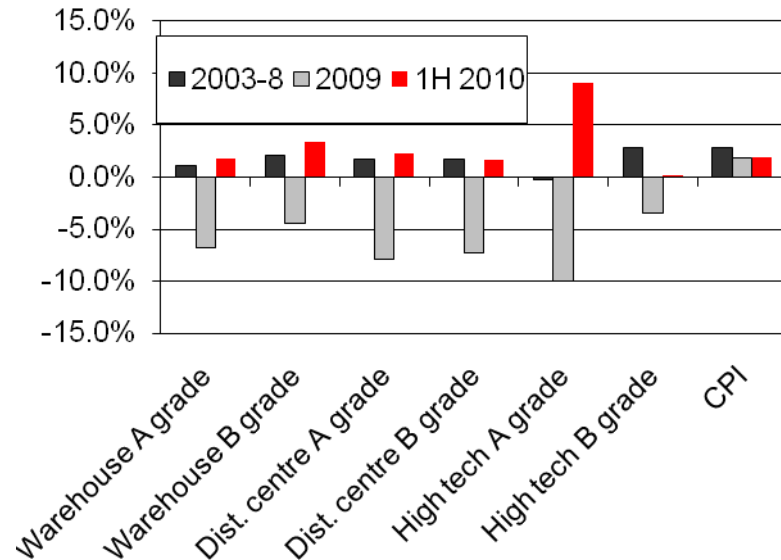


- Industrial construction lifted in 1 H 2010 from 255,000m² under construction at year start to 415,530 square metres by mid year.
- Over 70% is in the Western suburbs, with two major projects for K-Mart and Linfox dominating supply levels.
- Supply appears low in other areas, although a recent CBRE report covering projects below 5,000 square metres, indicate a number of smaller projects in the Northern and Eastern suburbs that could complete in 2011.
- The commencement of a number of projects in 1H 2010 has reduced the level of supply with development approval falling to 161,000 square metres.

Rents start to lift in 1H 2010. Growth to continue until supply lifts

Net effective rental growth - Melbourne

Annual growth rate



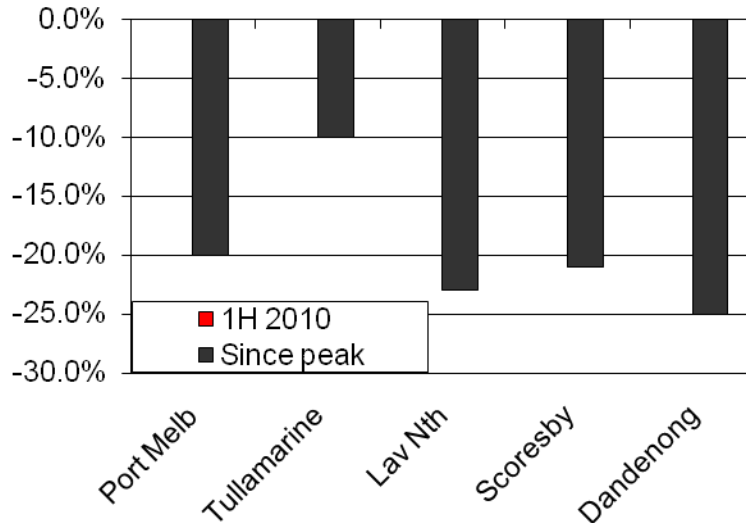
- The oversupply in Melbourne started to drive rents down in 2007. Rents fell by between 10% and 20% from the 2007 peak, although high tech prime rents fell by 23% to Q3 2009.
- As indicated in February, rents appear to have reached bottom, with growth across most sectors in 1H 2010.
- The considered oversupply from high construction pre-2008, also appears to have eased as incentives levels fell in 1H 2010. The largest fall was for prime high tech properties, down from 16% in Q3 2009 to around 10% in June 2010.
- Limited supply and continued improvement in the economy should help maintain pressure on rents to rise over 2010 and 2011. However, as this occurs, developers will be enticed back to the market and growth should settle back to historic levels of CPI or lower.

Source: CB Richard Ellis

Land values stabilise in 1H 2010

Change in land values for 0.25 ha standard serviced site - Melbourne

Annual growth rate

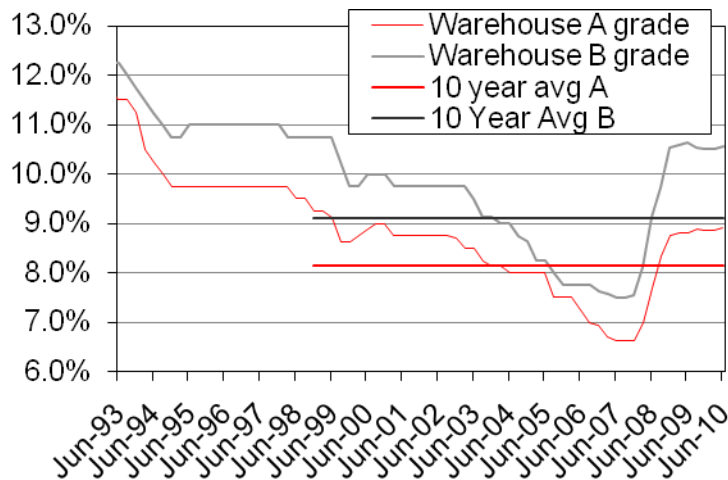


- As mentioned in February, signs that the fall in land values was stabilising was evident in Q4 2009. As expected this continued into 1H 2010, with all markets showing no change in land value.
- We maintain our consideration that projects with development approval or currently being planned will satisfy demand for the next year or so, which should keep land prices steady.
- As rental growth lifts over the next year and projects with DA commence, the viability and need for new development should increase. As demand for land increases, prices should start to recover from mid 2011.

Yields to firm over 2010 and into 2011

Industrial yields - Melbourne

Yield



- Our consideration that yields had bottomed out in Q3 2009 appears correct with little movement in the first half of 2010. However, expectations of potential firming did not occur, although we continue to forecast this for 2H 2010.
- Prime yields of around 9% and the potential for rental growth could well attract investors back to the market in 2H 2010. Activity in 1H 2010 was low at just over \$200 million, according to CB Richard Ellis, although they did consider that some major sales were being considered.
- With prime and secondary yields so far above average, the potential for firming in a sector with improving market fundamentals is strong. However, as caution is still evident, the strong growth in capital values should come from well leased prime properties.

Source: Raw data CB Richard Ellis

Analysis: Westpac Property

Disclaimer

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