

Marketview

Victoria Residential

Hot Topics

- Strong population growth driving house starts
- Strong rebound in Melbourne house and unit sales volumes
- Median house value rises by 14.3%, with the median unit value rising by 12.3%
- Melbourne's residential vacancy rate below 2.0% since the start of 2006

Market Overview

The Australian economy showed surprising resilience over the latter part of 2009. With the threat of a recession, be it technical or otherwise, seemingly passed, the economy heads into 2010 with a much more positive outlook. Government stimulus handouts, the temporary increase in the First Home Owner's Grant and the generational low interest rate setting all helped to support a generally resurgent residential market in 2009. This played a major role in the country avoiding the dreaded recession.

With the effects of the stimulus packages now largely through the system and interest rates climbing towards what is expected to be a neutral setting of between 5.0% and 5.5%, however, 2010 does appear to present a mixed and challenging environment for the residential markets.

The boost to the First Home Owner's Grant did indeed prove significant during 2009, providing support to a recovery in sales volumes, particularly in the sub-\$500,000 bracket, and increases in median house and unit values. While the grant has now returned to pre-boost levels, the ripple effects had begun to spread into the \$500,000 plus market by the end of the year.

Although first home buyers have begun to retreat – in November 2009 the first home buyer percent of dwellings financed had dropped to 22.1% nationally from their mid-2009 highs of above 28% - there is still solid momentum underway in many states which is likely to continue into the first part of 2010 as investors re-emerge. In many ways, however, it appears that while 2009 was characterized by efforts to re-invigorate the housing market, 2010 may well be marked by efforts to slow down the current pace.

Interestingly, residential markets nationally have acted quite uniformly since the onset of the global financial crisis. Rising interest rates, and the varied pace of recovery in individual states, including impacts on employment, are likely to see greater levels of divergence state-by-state emerge in 2010, driven by local economic conditions.

The Melbourne market generated a strong rebound in sales volume during 2009, according to Residex. The number of houses sold rose by 23.0% from 2008 to tally 54,392. Units recorded a similar rebound, with sales volume in 2009 totalling 33,882, a 21.9% increase on the 2008 total.

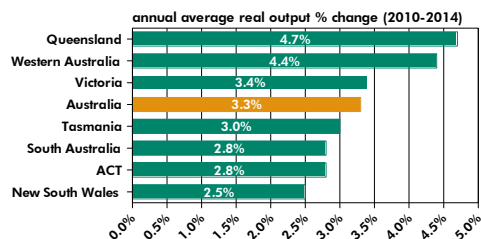
The December quarter 2009 median house value for Melbourne, as reported by Residex, grew by 14.3% over the year to reach \$543,500. The annual increase was well in excess of the 10-year average growth of 10.2% per annum. The Residex measure of Melbourne's unit value recorded a 12.3% increase over 2009 to reach \$411,500 at the December quarter. This compares with the 10-year average growth of 9.8% per annum.

The strength evident in the 2009 aggregate Melbourne sales and value growth figures was reflected across the metropolitan market. All precincts with the exception of Essendon, generated double digit growth in median house value and strong increases in sales volume. Similarly strong results were recorded across the Melbourne unit market.

Melbourne's vacancy rate at the September quarter 2009 was 1.3%, according to the Real Estate Institute of Australia. There has been little change over the past year. Vacancy has been below the 2.0% mark since the start of 2006 and below 3.0% since the start of 2005.

The key indicators of the Victorian Country house and unit market also showed generally positive signs in 2009 with solid value increases and sales volume growth. The median house value rose by 8.2% over the year to reach \$294,000 at the December quarter, according to Residex while units generated a 7.1% increase in median value during to reach \$231,500. Sales volume for houses increased by 12.2% compared with 2008, to 43,955, the second strongest year since 2003. Unit sales volume grew by 17.6% to 7,222, its highest level on record and the first time the calendar year aggregate has exceeded 7,000.

Average Annual Economic Growth 2010-2014

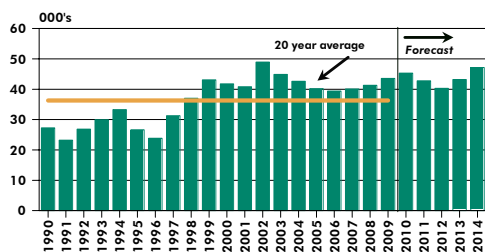


Source: Access Economics (January 2010)

Victorian economy showing strength

The economic downturn saw Victoria's growth move from being significantly above the national average in 2007 to below it in 2009. Yet, although the Victorian economy is weak, it is definitely recovering, as are its prospects. While expected higher interest rates and higher exchange rates are headwinds to the State's manufacturing sector, Victoria looks likely to continue to persistently achieve reasonable levels of economic growth. High population growth provides for further retail growth in the simplest of forms – more people visiting shops. Additionally, the population growth has supported the residential building sector during this time, a key source of employment. This has helped to underpin the state as consumers display a willingness to spend, with the positive sentiment spreading across other sectors of the economy. From 2010 to 2014, the Victoria's per annum economic outgrowth is forecast to be marginally ahead of the national growth rate.

Housing Starts Victoria

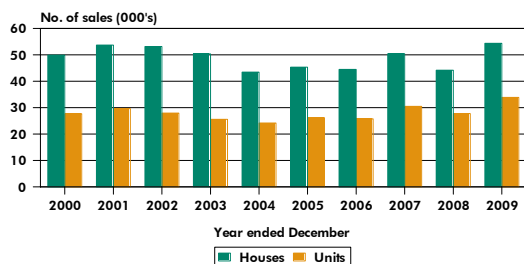


Source: Access Economics - January 2010

More new homes than NSW or Queensland

The coming Victorian housing construction upswing had appeared likely to be more muted than that seen nationally given that Victoria has relatively less pent up demand than some other States. However, the better population growth looks in Victoria, the better is the State's short term housing construction outlook, according to Access Economics. Thanks to the rapid population growth, a healthy rate of recovery in housing finance and solid gains in building approvals point to a solid increase in the pace of housing construction through 2010 and into 2011. Rising mortgage interest rates will generate an important headwind, but demographic positives should outweigh mortgage rate negatives. After a solid 2009 (increasing 5.4% while the national figure tumbled 11%), housing starts are forecast to be little changed in the next couple of years. They are projected to increase by 4.0% in 2010 but fall by 5.6% in 2011. Yet, even with that flat profile, Victoria will still be building many more new homes in 2010 and 2011 than either New South Wales or Queensland.

Annual Sales Volume Houses and Units, Melbourne

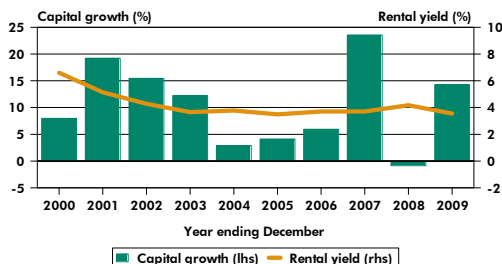


Source: Residex (December Quarter 2009)

Melbourne the most active market for house sales

The Melbourne market generated a strong rebound in sales volume during 2009, according to Residex. The number of houses sold rose by 23.0% from 2008 to tally 54,392. Melbourne was the most active house market in the country, and the increase in sales volume compared with a 16% increase nationally. Units recorded a similar rebound. Sales volume in 2009 totalled 33,882, a 21.9% increase on the 2008 total. The increase was marginally ahead of the national increase, at 20.1%. Both measures were, in fact, at their highest levels in at least a decade. Population growth, particularly overseas migration, and the impacts of the boosted First Home Owner's Grants appear the key drivers. Numerically, the Melbourne metropolitan area is attracting more new residents than any other metropolitan area in Australia (75,000 in 2007-08 for example, compared with 55,000 in Sydney and 43,000 in Brisbane and Perth). Net overseas migration to Victoria has increased substantially, and in 2008-09 accounted for 69% of the total state population increase.

Capital Growth and Rental Yield Melbourne Houses

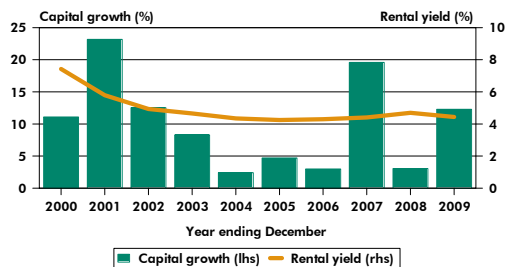


Source: Residex (December Quarter 2009)

Median house value grows by 14.3%

The December quarter 2009 median house value for Melbourne, as reported by Residex, grew by 14.3% over the year to reach \$543,500. The annual increase was well in excess of the 10-year average growth of 10.2% per annum. Four of the preceding five years generated modest annual growth of 6% or less (including a marginal decline of 0.9% in 2008), broken only by a substantial increase in 2007. Melbourne's 2009 increase was the second highest of all capital city markets, only slightly behind the 14.9% rise generated in Darwin. Nationally, the median house value increased by 6.8% over the year. With a \$10 per week decline in median rent to \$370 per week in the December quarter, however, the rental yield had fallen noticeably to 3.55% compared with 4.17% twelve-months earlier. The yield is the lowest of any of the major markets nationally and compares with, for example, yields of 3.80% in Sydney and 4.04% in Brisbane.

Capital Growth and Rental Yield Melbourne Units



Source : Residex (December Quarter 2009)

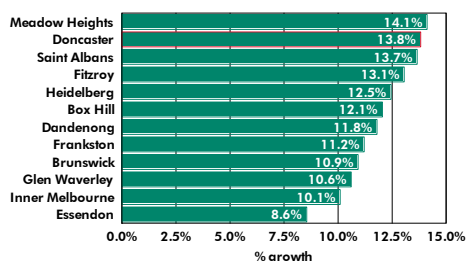
Melbourne unit value increases by 12.3%

The Residex measure of Melbourne's unit value recorded a 12.3% increase over 2009 to reach \$411,500 at the December quarter. This compares with the 10-year average growth of 9.8% per annum. Melbourne recorded the second strongest growth result in 2009 nationally, behind just the 17.6% recorded in Darwin. The 2009 increase was almost twice the 6.3% increase recorded nationally. Similar to the house market, the 2009 growth was well above four of the preceding five years, which recorded increases sub-5.0%, interrupted only by a very strong 2007. Melbourne's median unit value is the second highest of any capital city market and compares with the national median of \$371,500. The median weekly rent for a Melbourne unit was \$350 in the December quarter, equal to the national median and rising by rising by \$20 per week from a year earlier. Despite the increase, rental yield has eased to 4.44% compared with 4.70% in the December quarter 2008.

Strength across the market

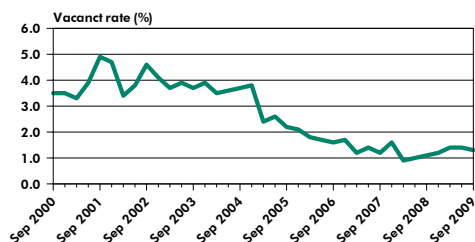
The strength evident in the 2009 aggregate Melbourne sales and value growth figures was reflected across the metropolitan market. Based on the precinct by precinct breakdown from Residex, the strongest areas of house value growth were Meadow Heights (postcodes 3042 to 3048) with a 14.1% increase in value, Doncaster (postcodes 3097 to 3027) with a 13.8% increase and Saint Albans (postcodes 3020 to 3030) with a 13.7% increase. All precincts with the exception of Essendon, however, generated double digit growth. All precincts also recorded strong increases in sales volume. Similarly strong results were recorded across the Melbourne unit market, with value increases ranging from 11.7% for the Inner/North West precinct (postcodes 3000 to 3079) to 14.4% for the North East Precinct (postcodes 3080 to 3140). As with the house market, sales volumes also increased across all precincts.

Median House Value Growth Melbourne Precincts, 2009



Source : Residex (December Quarter 2009)

Residential Vacancy Rate Melbourne

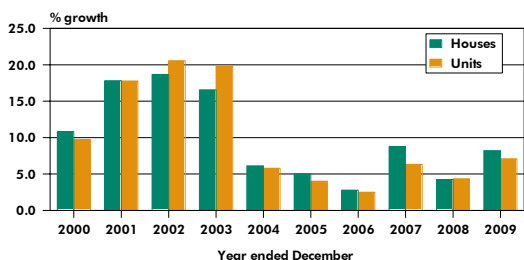


Source : REIA

Vacancy rate changes little in 2009

Melbourne's vacancy rate at the September quarter 2009 was 1.3%, according to the Real Estate Institute of Australia. There has been little change over the past year. Vacancy has been below the 2.0% mark since the start of 2006 and below 3.0% since the start of 2005. More detailed data from the Real Estate Institute of Victoria shows tightness across the market, with the Inner Melbourne (0-4 kilometre radius of the CBD) vacancy rate at 1.4% and the Inner Melbourne (4-10 kilometre radius of the CBD) vacancy rate at 1.3%. Middle Melbourne recorded a vacancy rate of 1.9% while in the outer suburbs, the vacancy rate sat at just 0.6%. December quarterly rental data provided by the Victorian Office of Housing shows a degree of annual growth in the tight environment. The median weekly rent for two-bedroom flats in metropolitan Melbourne rose by 10.7% over 2009 to \$310 per week and the three-bedroom house median rose by 11.1% to \$300 per week. Rents were largely stable in the December quarter alone, however.

Annual Capital Growth Houses & Units, Country Victoria



Source : Residex (December Quarter 2009)

Victorian Country market performs well

The key indicators of the Victorian Country house and unit market also showed generally positive signs in 2009 with solid value increases and sales volume growth. The median house value rose by 8.2%, according to Residex, with the December quarter median house value at \$294,000. Sales volume increased by 12.2% compared with 2008, to 43,955, the second strongest year since 2003. The median rent increased by \$20 per week in 2009 to reach \$280 per week at the December quarter, with the rental yield effectively unchanged from a year earlier at 4.97%. Country Victorian units generated a 7.1% increase in median value during 2009 to reach \$231,500 at the December quarter. This was the strongest annual growth rate since the boom period from 2001 to 2003, where growth of around 20% per annum occurred. Sales volume grew by 17.6% to 7,222, its highest level on record and the first time the calendar year aggregate has exceeded 7,000. A \$20 per week increase in the median rent to \$220 per week result in a strengthening of the rental yield to 4.95%.

Market Outlook

With the Federal Government's First Home Owner's Grant having returned to its pre-boost levels and three consecutive interest rate rises from October to December 2009, conditions have been set for a mixed and challenging 2010 for the residential sector.

The Reserve Bank of Australia (RBA) surprised most by leaving the official cash rate unchanged at 3.75% at their February 2010 Board meeting, their first of 2010.

In the statement released subsequent to the Board meeting, the RBA highlighted that Australian economic conditions have been stronger than expected. While the effects of the fiscal stimulus on consumer demand has now faded, household finances are being supported by strong labour market conditions and a recovery in net worth. Credit for housing has been expanding at a solid pace and dwelling prices have risen significantly over the past year.

Importantly, the statement identified that interest rates to most borrowers remain lower than average. If economic conditions evolve broadly as expected, it is likely that monetary policy will need to be adjusted further to ensure that inflation remains consistent with the medium term target.

In short, expect further rises to the cash rate in 2010. Most analysts are still suggesting the rate will have returned to a more neutral setting of around 5.00% by the end of 2010.

As one of the top performing markets nationally in 2009, the residential market in Victoria has enormous momentum behind it going into 2010. This is evident across almost all market segments. Strong price growth, high auction clearance rates and high sales volumes were evident right until the week before Christmas.

There has been a seasonal slowdown during the Christmas break, but confidence in Melbourne's market remains high and the patterns of growth are expected to continue unabated well into 2010, driven by strong underlying fundamentals including population growth and economic performance.

The first home owner was a big part of the market in 2009. The average loan size for first home buyers in Victoria sat below \$230,000 until towards the middle of 2008. It then trended upward to a peak of \$279,400 in December 2009. The first home buyer share of owner occupier dwelling finance commitments in Victoria increased from a mark around 20% in 2008 to over 29% in mid-2009.

With the First Home Owner's Grants now back to their pre-stimulus levels and interest rates rising, there are signs of a slowdown in the sub-\$500,000 market. At this stage, however, the slowdown has not translated into any significant negative turnaround.

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