

Addendum – QBE LMI Outlook for the Australian Property Market October 2008 **Tuesday 14th October**

In light of the recent deterioration in global financial markets and the RBA's 100 basis point cut in the official cash rate in October, BIS Shrapnel will be revising its short-to-medium term economic outlook.

The Australian economy has not been immune to the global crisis of confidence, despite not suffering from an overhang of capacity and continuing to benefit from strong income flows as a result of the commodity boom. Credit growth slowed sharply through the first half of 2008 and consumer spending contracted in the second quarter. Employment growth slowed, but the labour market remained tight and disposable incomes continued to post solid growth, despite the rise in interest rates.

The significant pipeline of mining and infrastructure works underway will continue to support investment through 2009. With the US, UK and possibly parts of Europe expected to be in recession through 2009, commodity prices are likely to fall further. But in the absence of a sharp slowdown in Chinese investment growth, many of the planned mining and associated infrastructure projects, particularly oil, gas, coal and iron ore, will remain economically viable. Moreover, the long lead times for projects and their scale means that activity would be slow to adjust down to a drop in demand. Strong government revenues, particularly federal, have also been underpinning a major round of infrastructure investment. The Federal Government has scope to fast-track projects to provide a counter-cyclical boost to activity, but it would still take time for construction activity to ramp up.

While engineering construction activity is expected to remain resilient through the current financial turmoil, discretionary investment spending on machinery and equipment is likely to be scaled back. The current climate of risk aversion has also made it difficult for speculative building projects to attain finance and the deleveraging process is a global phenomenon, with businesses often being required to reduce their gearing levels before they can refinance loans. This has impacted on demand for industrial and commercial property, despite broadly favourable leasing conditions. Therefore the level of non-dwelling building is set to fall significantly once the current round of construction has been completed.

Dwelling approvals also softened as a result of the run up in interest rates. However, the commercial banks passed on 80 basis points of the 100 basis point cut in official interest rates in October and we are now forecasting the standard housing variable rate to fall to 8.1% by June 2009, remaining at 8.1% by December 2009, before declining a further 0.3% to 7.8% by June 2010. In the absence of wholesale job losses and a blow out in unemployment (which we are not anticipating), sharp drops in house prices are unlikely and the undersupply of dwellings will effectively put a floor in construction.

Despite the massive government and central bank intervention programs overseas, the credit crisis has further to run and it will take time for confidence to be restored.

The current pipeline of construction work and the strength of mining incomes will support the Australian economy in the near term. The recent depreciation in the A\$ will also support export volumes, although this will be offset to a large extent by the slowdown in world demand.

However, the resilience of growth largely depends on whether consumer confidence returns sufficiently to prevent a sharply domestically-driven slowdown. On balance, we expect that the economy will sustain growth at 2.5 to 3% through 2008/09, but calendar 2009 will see growth weaken further as a result of a gap in building activity. However this gap will increasingly be filled through 2010 by an upswing in dwelling building as confidence returns and lower interest rates encourage the release of significant pent-up demand for housing.



Outlook for the Australian Property Market

October 2008

WELCOME AND INTRODUCTION	4
EXECUTIVE SUMMARY	6
1 ECONOMIC OUTLOOK	10
2 RESIDENTIAL DEMAND	14
2.1 Home loan activity	15
2.1.1 Owner occupier loan activity	15
2.1.2 Investor loan activity	16
2.2 Demand and supply	19
2.2.1 Rentals	20
2.3 Trends in migration	22
2.3.1 Net overseas migration	22
2.3.2 Net interstate migration	23
3 SYDNEY	25
3.1 State of play	25
3.2 Forecast	27
4 MELBOURNE	29
4.1 State of play	29
4.2 Forecast	30
5 BRISBANE	32
5.1 State of play	32
5.2 Forecast	33
6 ADELAIDE	35
6.1 State of play	35
6.2 Forecast	36
7 PERTH	39
7.1 State of play	39
7.2 Forecast	40
8 HOBART	43
8.1 State of play	43
8.2 Forecast	45
9 DARWIN	46
9.1 State of play	46
9.2 Forecast	46
10 CANBERRA	48
10.1 State of play	48
10.2 Forecast	49

Welcome and Introduction



I am delighted to introduce you to our October issue of the Outlook for the Australian Property Market Report, which has been compiled in conjunction with BIS Shrapnel, leading business research and forecasters. The forecasts in the report represent an independent and expert view of the residential housing market in Australia. This report follows the release in March of our Residential Property Overview.

One thing that you will see following the purchase of the company by QBE Insurance Group (QBE) in October 2008, is our change in name from PMI Mortgage Insurance Ltd (PMI) to QBE Lenders' Mortgage Insurance Limited (QBE LMI). While there has been a change in name, the leadership of the company continues under the existing management, as such it is very much business as usual.

QBE is Australia's largest international insurance and reinsurance group and one of the top 25 insurers in the world, has offices in 48 countries with over 10,000 employees. QBE has undertaken to maintain QBE LMI's Standard & Poor's AA- insurer financial strength ratings, and a satisfactory level of capital above the minimum required by regulators.

In this uncertain environment, we believe our customers will clearly benefit from the financial strength, expertise and operational excellence of QBE, and will welcome the stability brought by this change in the ownership of the business.

The purchase of our company is in line with QBE's strategy of diversifying into lenders mortgage insurance, a new product line. We see QBE's commitment to lenders mortgage insurance in Australia and New Zealand as a real vote of confidence and recognition of the capabilities of our people and our leadership role in the industry.

While it is accepted that the liquidity/credit events in the US are placing significant pressure on global economies and financial systems, Australia is better placed to deal with the short term challenges that these present for us. This is reinforced in the most recent reports issued by the International Monetary Fund and the Reserve Bank of Australia in September.

Notwithstanding our forecasts confirm that the Australian economy is under increasing pressure with a sharp slowdown expected in 2008/09. The extent of this slowdown is very much dependent upon world financial events and their impact on continued demand for our commodities, and the willingness of the RBA to provide further official interest rate relief in the year ahead.

Unlike other housing markets in the OECD major economies around the world, which are experiencing significant decline in property prices, the forecast for Australia is less pessimistic with modest price growth forecast over the next few years.

As the Outlook for the Australian Property Market Report states amongst other things, there is a significant undersupply of housing stock that is emerging in the major capital cities, which reflects higher level of immigration/population growth projected over the forecast period.

With demand projected to exceed supply for 2009/11, any property price declines are expected to be modest, with some prospect of property price growth returning following official interest rate reductions in 2009.

QBE LMI has been operating in the Australian residential mortgage market for over 40 years and has protected mortgage lenders from loss throughout many cycles over that time. A positive in the current cycle for the Australian housing market is that while we are experiencing a significant slowdown, the increase in defaults and losses while trending up are in line with our long term experience.

Our mission as QBE LMI continues to be to facilitate home ownership for all Australian families in these uncertain times. We do this by giving mortgage lenders the security and confidence that LMI can provide, this enables them to continue lend to credit worthy borrowers at competitive interest rates where only a low deposit is available.

We trust you find the report and its forecasts insightful and helpful on what we can expect from the Australian economy and housing market. I am personally delighted to have the opportunity to introduce QBE, our new shareholder, to you and share our outlook for the Australian housing market.



Ian T Graham
Chief Executive Officer

Executive Summary



Residential market conditions across most of Australia's capital cities peaked during the second half of 2007, before price growth eased in the first half of 2008. Home affordability, which was already constrained by solid price growth and four 0.25% interest rate rises over the eighteen months to December 2007, deteriorated further due to the housing variable rate increasing by 0.9% in the six months to June 2008. Subsequently at June 2008, affordability levels were the poorest they have been since 1989 in Sydney and Melbourne, while in all other capital cities, the deterioration in affordability had surpassed previous highs.

This has led to a considerable weakening in demand for residential property, highlighted by the fall away in demand by both owner occupiers and investors. Nationally, the number of owner occupier loans declined by 18% over the six months to June 2008, compared to the six months to December 2007, while the value of loans to investors fell by 15%.

As a result, only Adelaide experienced an improvement in median house price growth in 2007/08 compared to the previous year, while Brisbane witnessed very similar price growth. Although easing, price growth was still solid in Melbourne, Hobart and Darwin in 2007/08, while it was much more moderate in Canberra.

In Sydney and Perth, housing affordability had already reached its limitations prior to 2007/08, providing little scope for price growth during the year. Subsequently, these two capital cities experienced the lowest median house price growth in 2007/08, with median house prices in Perth even declining slightly over the year.

Despite a 0.25% cash rate cut in September 2008, and another 0.25% reduction in the first half of 2009, poor affordability is expected to remain a major constraint to price growth in 2008/09. Consumer confidence is likely to be further dampened by a mild slowing in economic conditions causing a rise in the unemployment rate. With purchaser sentiment weak, median house price growth in all capital cities in 2008/09 is forecast to be lower than that attained in 2007/08, except for Perth, which is projected to achieve minimal growth after house prices declined the previous year.

Moderate to low price growth and two interest rate drops forecast over 2008/09, combined with a further 0.5% fall in housing variable rates projected in 2009/10, is expected to improve housing affordability. At the same time, high population inflows from overseas migration are expected to underpin a further strengthening in underlying demand, which is already outpacing new dwelling construction, and is forecast to continue to do so in the three years to 2010/11 in most capital cities.

Table 1: Median house prices by capital city

Quarter Ended June	Sydney		Melbourne		Brisbane		Adelaide	
	\$0'00	% variable	\$0'00	% variable	\$0'00	% variable	\$0'00	% variable
2002	452.0	24.2	330.5	9.4	185.0	15.6	170.0	14.6
2003	519.0	14.8	355.0	7.4	235.0	27.0	220.0	29.4
2004	552.0	6.4	365.0	2.8	307.3	30.7	250.0	16.6
2005	528.0	-4.3	360.0	-1.4	315.0	2.5	275.0	10.0
2006	526.8	-0.2	371.1	3.1	326.0	3.5	287.0	4.4
2007	530.5	0.7	415.0	11.8	366.3	12.4	312.8	9.0
2008	536.0	1.0	451.0	8.7	412.0	12.5	365.0	16.7
FORECAST								
2009	540.0	0.7	460.0	2.0	418.0	1.5	380.0	4.1
2010	565.0	4.6	485.0	5.4	455.0	8.9	400.0	5.3
2011	615.0	8.8	525.0	8.2	490.0	7.7	425.0	6.3

Quarter Ended June	Perth		Hobart		Canberra		Darwin	
	\$0'00	% variable	\$0'00	% variable	\$0'00	% variable	\$0'00	% variable
2002	185.7	12.1	130.0	8.1	227.6	12.1	200.0	7.0
2003	210.2	13.2	180.0	38.5	320.0	40.6	206.0	3.0
2004	255.0	21.3	252.0	40.0	372.4	16.4	255.0	23.8
2005	295.0	15.7	260.0	3.2	352.5	-5.3	279.8	9.7
2006	400.0	35.6	277.0	6.5	380.1	7.8	350.0	25.1
2007	452.0	13.0	310.0	11.9	426.5	12.2	395.0	12.9
2008	446.0	-1.3	330.0	6.5	440.0	3.2	425.0	7.6
FORECAST								
2009	460.0	3.1	330.0	0.0	450.0	2.3	435.0	2.4
2010	470.0	2.2	345.0	4.5	475.0	5.6	470.0	8.0
2011	500.0	6.4	365.0	5.8	510.0	7.4	505.0	7.4

Source: Real Estate Institute of Australia and BIS Shrapnel

The current tightness in residential markets around Australia is likely to become more acute over the forecast period, in particular in Sydney, Melbourne and Brisbane, leading to increased stock deficiency levels and vacancy rates remaining low. With demand higher than new supply during the forecast period, capital cities are expected to experience solid rental growth.

The ongoing pressure in the rental market is likely to see an increasing number of renters become owner occupiers, rather than continue to face significant rental increases. Also, improving rental yields should eventually encourage investor

demand, which is expected to assist price growth as well.

Therefore, median house price growth is forecast to increase in the two years to 2010/11, totalling more than 10% in all capital cities, except Perth.

SYDNEY

Affordability reached a challenging level in Sydney by June 2004, after median house prices rose by a substantial 52% in the three years to 2003/04. This resulted in a correction in the Sydney market with the median house price declining by 4% in 2004/05 and remaining flat thereafter, marginally increasing

to \$536,000 at June 2008. Growth in Sydney's median house price is likely to be limited in 2008/09 as poor affordability remains a concern due to the interest rate rises over 2007/08. However, the decline in new dwelling construction means that a substantial deficiency of dwellings is emerging, reflected by strong rental growth and improvement in yields. Falls in the housing variable rate expected in 2008/09 and 2009/10 are projected to feed through to solid house price growth from 2009/10. The median house price is forecast to increase to \$615,000 by June 2011, which represents growth of 14% in the two years to 2010/11.



MELBOURNE

Melbourne experienced solid median house price growth over the two years to 2007/08. Following a cumulative rise of 5% between June 2003 and June 2006, house prices increased by 11.8% in 2006/07 and 8.7% in 2007/08. This growth was underpinned by strong underlying demand and a rising deficiency of dwellings, as well as very strong employment and income growth. However, the upward momentum in Melbourne's residential property stalled in the first half of 2008, due to deteriorating affordability affecting sentiment. This is likely to continue to occur in 2008/09, limiting price growth to 2% for the year. The forecast decline in the cash rate in 2008/09 and falls in the housing variable rate in 2009/10, are expected to release some of the demand pressures onto the market. As a result, price growth is forecast to increase to 5.4% in 2009/10 and then to 8.2% in 2010/11. The median house price at June 2011 of \$525,000 will represent 16% growth over the forecast period.

BRISBANE

Brisbane, similarly to Sydney, appeared to have reached its affordability limitations by June 2004, after median house prices increased by 92% over the three years to 2003/04. As a result, price growth did slow over the following two years to 2005/06, although it still remained positive registering 6% growth. However, robust economic conditions, driven by the booming resource investment sector, have continued to underpin strong wage growth and underlying demand. This has increased stock deficiency levels and supported solid house price growth of above 12% in both 2006/07 and 2007/08. This growth, combined with the high interest rate environment, has led to deteriorated affordability in Brisbane, causing buyer sentiment to fall, which is likely to limit price growth to just 1.5% in 2008/09. Despite higher new dwelling construction alleviating some upward pressure on prices, as the stock deficiency drops, strengthening economic conditions and forecast falls in the housing

variable rates are expected to drive median house price growth of 8.9% in 2009/10 and 7.7% in 2010/11.

ADELAIDE

Median house prices in Adelaide increased by a considerable 85% over the four years to 2004/05, before growth slowed to 4% in 2005/06. While new dwelling activity appears to be matching underlying demand at the state level, vacancy rates of below 2% since March 2005 in Adelaide suggests a deficiency exists in the city. This has driven recent house price growth of 9% in 2006/07 and 16.7% in 2007/08, which was the highest growth rate for the year to June 2008. Superior affordability in Adelaide, compared to most other capitals, has allowed the city to better withstand affordability concerns, due to the high interest rate environment. As a result, Adelaide is again expected to witness the greatest house price growth in 2008/09 of 4.1%, before price growth increases slightly to 5.3% in 2009/10 and 6.4% in 2010/11.

“Residential market conditions across most of Australia’s capital cities peaked during the second half of 2007, before price growth eased in the first half of 2008”

PERTH

Perth’s median house price showed compound growth averaging 18% per annum (or 169% total growth) between June 2001 and June 2007, rising from \$165,700 to \$446,000. Attractive affordability up until 2004/05 and booming economic conditions, led by strong investment in the resource sector, underpinned high wages growth and net migration inflows. This in turn strengthened demand for residential property, driving this substantial increase in house prices. However, the price growth between 2001 and 2007, combined with the rises in interest rates during that time, and the additional four rises in 2007/08, have caused affordability to weaken to long term low levels at June 2008. As a result, Perth’s median house price declined by 1.3% in 2007/08 to \$446,000. Affordability issues are expected to continue affecting price growth over the two years to 2009/10, before they ease, which is likely to provide scope for solid growth in 2010/11. Overall, 12% house price growth is projected in Perth over the forecast period.

HOBART

Median house price growth of 94% in Hobart over the two years to June 2004 was driven by increased demand from a high net interstate migration inflow. With interstate migration reverting back to a small inflow in 2004/05, price growth slowed to 3% in the year. However, house prices in Hobart have accelerated over the last three years

to 2007/08, growing at an average rate of 8.3% to reach \$330,000 at June 2008. Over the forecast period, demand is projected to become more subdued as net interstate migration outflow averages 1,000 persons per annum, whilst a high interest rate environment impacts on price growth. Hobart’s median house price is forecast to show no growth in 2008/09, before increasing by 10.6% in the two years to 2010/11.

CANBERRA

Median house price growth in Canberra recovered from a 5.3% decline in 2004/05, to increase by a solid 7.8% in 2005/06 and 12.2% in 2006/07. High net interstate migration inflows, generated by strong growth in Federal Government employment, boosted demand and supported this price growth. However, the change in Federal Government has created uncertainty about public sector employment prospects, evident by the minimal net inflow from interstate migration in 2007/08. An easing in demand has seen price growth in Canberra slow to 3.2% in the year to June 2008. The cumulative effects of interest rate rises in 2007/08 are also expected to have an impact on price growth, which is forecast to be a minimal 2.3% in 2008/09. Growth is then projected to pick up to 5.6% in 2009/10 and 7.4% in 2010/11 as an upturn in economic growth stimulates demand.

DARWIN

Darwin’s median house price

has increased on average by a compound 16% annually from \$206,000 at June 2003 to \$425,000 at June 2008. Like Western Australia, the Northern Territory has benefited from a boom in mining and resources investment, resulting in an improvement in the net interstate migration outflow and net overseas migration inflow. However, this level of price growth and the numerous interest rates during the last five years to June 2008 has placed a heavy strain on affordability in Darwin. Despite the current boom expected to continue to support price growth in the forecast period, the deterioration in affordability is forecast to limit growth to 2.4% in 2008/09. Although, with the housing variable rate projected to fall in 2008/09 and 2009/10, affordability will improve, increasing price growth to forecast 8% in 2009/10 and 7.4% in 2010/11.

1. Economic Outlook



Despite growing strongly in 2007/08 (GDP grew by 3.7%), Australian economic growth has begun decelerating over the past six months. Through-the-year growth has stuttered to 2.7% in June quarter 2008, down from 3.3% in the March quarter and 4.2% in the December quarter of 2007.

Growth in domestic spending by businesses and households slowed from the unsustainably strong 2007 pace, as business and consumer confidence were negatively affected by official interest rate rises, the US-inspired credit squeeze, share market declines, a jump in inflation and, finally, by escalating oil prices.

However, employment and wages growth remains strong in 2007/08, on the back of strong profit results. The mining sector led the way, with profits surging on the back of higher iron ore and coal contract prices. The disparity between income and expenditure growth suggests an element of precautionary saving by both consumers and businesses. It appears that the pessimism which has gripped the US, UK and parts of Europe — who are dealing with the fallout of substantial financial sector losses, rising unemployment and sharp residential downturns — has taken hold, despite the underlying strength of the Australian economy.

Despite the shortage of labour, in particular the shortage of skilled labour, wages growth was not the over-riding driver of inflation in 2007/08. Instead, it was a combination of demand inflationary pressures, high world commodity prices and domestic supply constraints in the provision of housing, energy and food, which saw underlying CPI inflation pick up through the year to 4.5% by June 2008.

The economy's capacity to supply has not kept pace with the strengthening in demand (consumer and investment spending) over the past year, with GDP (output) growth at 3.7% in 2007/08 compared to growth in Gross National Expenditure (GNE) at 5.4%. Capacity constraints have restrained the growth in construction activity, with a rising — and large — backlog of work still to get through both in the non-residential construction and residential building sectors. The capacity constraints have been especially evident in exports of resources, with transport infrastructure bottlenecks and the slow ramp-up of mining and processing capacity restricting the supply response to strong overseas demand. The lingering drought also saw rural exports decline for the third year in a row. Meanwhile, the high A\$ has undermined the competitiveness of the tradeables sectors, and although non-commodity manufactured exports have been able to maintain moderate volume growth, the volume growth of services exports (mainly inbound tourism and education) has slowed.

In September 2008, in an effort to curb the decline in business and consumer spending and restore some confidence in the economy, the Reserve Bank of Australia dropped the cash rate by 25 basis points. However, having now seen the strength of investment, incomes and profit data, the Bank knows that there is a thin line to tread between providing a soft landing for the household sector and risking rekindling inflationary embers.

Business investment is expected to remain the key growth driver over 2008/09. The resilience of consumer spending is the by-product of the economy's employment boom and successive large tax cuts. Consumer spending itself is now a key driver of employment, but the overriding stimulus for employment and income has come from investment. While the credit crunch and weak world outlook may help temper investment, its impact is not expected to be pronounced. In fact, the most likely outcome would be for these transitory constraints to delay investment, with the result of extending the boom.

By June 2009, the drivers of economic growth are forecast to shift. Growth in domestic demand will continue to moderate through 2008/09, constrained by (still) tight credit conditions and enforced Federal Government spending cuts. A modest easing in credit conditions will help stem the downturn in consumer confidence and retail spending, but a slowdown in employment growth will continue to encourage an element of precautionary saving. Employment growth in 2007/08 is expected to fall to 1.1% (August on August), as the unemployment rate rises to 5.1% (August).

This moderation in domestic demand however, will be offset to an extent by an upturn in commodity exports. Consequently, GDP growth will become more balanced at 3.3%.

By June 2010, business investment will be starting to run out of steam.



Significant falls in commodity prices and the completion of a number of major projects will lead to a mild downturn in mining investment, but continued strong demand for coal, iron ore, oil and gas will prevent a collapse in activity.

New public investment is expected to bottom out in 2009/10, along with private investment in non-dwelling building activity and equipment. However, a lower A\$ will stimulate the tourism and tradeables sectors in general, which will provide a modest countercyclical boost to business investment.

The key driver of investment activity from 2009/10 will be dwelling investment. The forecast 0.25% decline in interest rates by the Reserve Bank of Australia in early 2009, along with independent declines by the banks (after continued political and consumer pressure) equating to an expected

0.5% in late 2009, should provide some stimulus to purchaser demand for residential property as affordability improves. This easing in credit conditions, along with the start of renewed competition by mortgage lenders and the tightness in the rental sector will encourage a strong round of dwelling activity, centred on Sydney, Brisbane and Melbourne.

Going into 2011, the outlook is for a recovery to get underway led by dwelling construction in private investment (11.2% for 2010/11), with economic growth subsequently strengthening as consumer demand and finally business investment improves. During this period, an improved export performance will help underpin GDP growth, and as a result, GDP is forecast to rise to 4.4%.

Table 2 shows the percentage change and forecasts for a range of key economic indicators.

Table 2: Economic indicators

Year Ended June	2005	2006	2007	2008	Forecasts		
					2009	2010	2011
EXPENDITURE ON GDP (at average 2004/05 prices)							
Consumption							
- Private consumption	4.4	2.6	4.0	3.9	2.6	3.1	4.6
- Government consumption	3.8	2.5	2.9	3.4	2.8	2.1	3.3
Private Investment							
- Dwellings	-0.8	-4.3	2.4	1.5	4.1	8.5	11.2
- Real estate transfer expenditure	-16.6	2.3	-0.9	0.4	-6.0	17.0	13.5
- New non-dwelling construction	9.0	19.9	14.4	10.7	4.7	0.8	0.8
- New equipment	15.2	15.1	3.4	11.7	10.5	2.0	9.0
- New business investment (+)	12.0	15.8	7.3	11.7	8.2	2.1	5.6
New Public Investment	9.3	9.3	8.3	11.0	3.8	1.0	4.0
Gross National Expenditure (GNE)	4.7	3.8	4.4	5.4	3.3	3.2	5.4
GDP (average)	2.8	3.0	3.3	3.7	3.3	3.7	4.4
Inflation and wages (June on June)							
CPI	2.5	4.0	2.1	4.5	3.8	3.1	2.9
Baseline	2.3	2.4	2.6	4.2	3.8	3.2	2.9
Average weekly earnings (year average)	5.9	3.5	5.2	3.9	5.4	4.7	5.3
Employment (%)							
- Employment growth (August on August)	4.1	2.1	2.6	2.3	1.1	1.7	2.8
- Unemployment rate (August)	4.7	4.5	4.1	3.9	4.8	4.8	4.2
Interest rates (% at 30 June)							
- Cash rate	5.50	5.75	6.25	7.25	6.75	6.75	7.00
- Housing (variable)	7.30	7.55	8.05	9.45	9.10	8.60	8.85

Source: Australian Bureau of Statistics, BIS Shrapnel



“Significant uncertainty exists as to the full fallout of the credit crisis and how any further effects will filter through into the Australia economy”

INTEREST RATES

Whilst underlying inflation has remained under control over the past few years, staying within the Reserve Bank's prescribed 2–3% range, the inflationary threat has gradually increased. The RBA's response has been the tightening of monetary policy. The standard variable rate increased from 7.3% in June 2005 to 8.05% in June 2007.

This decision was due to a range of factors. Underlying measures of inflation continued to show upward movement, and while retail sales and dwelling construction was subdued, business investment showed strong growth. Most importantly, employment growth remained robust, raising concerns about acceleration of labour costs that might eventually force the rate of inflation higher.

Further monetary tightening was then experienced in the second half of 2007 and in the first half of 2008.

The continued tightening of the labour market and resilient retail spending continued to underpin inflationary concerns.

However, variable housing rates have risen above the increases prescribed by the RBA. Increased borrowing costs caused by the credit crisis in the US and a higher risk of default caused by higher borrowing costs, threaten to diminish the margin made by banks in home lending. Banks have reacted by increasing their variable and fixed mortgage rates to protect profit margins. As a result, the variable rate in June 2008 was 9.45%. A further increase of 0.15% by financial institutions took the standard variable rate to 9.6% in July 2008.

In September 2008, the RBA lowered interest rates 25 basis points, the first official rate cut since 2001. The reason was a marked deterioration in economic conditions through the first six months of 2008, as

consumer confidence plunged, retail turnover fell, business and consumer credit growth slowed, and building approvals nationally (both dwelling and non-dwelling) declined.

The outlook for interest rates for the remainder of 2008 and going into 2009 is uncertain. Significant uncertainty exists as to the full fallout of the credit crisis and how any further effects will filter through into the Australia economy. In addition, the deterioration in economic conditions over the first half of 2008 is likely to continue going into 2009.

Despite this, the Reserve Bank of Australia is expected to drop the cash rate once again in the early part of 2009 by a further 0.25% in an effort to maintain consumer and business confidence. By June 2009, after a 0.5% decline in the cash rate, the standard variable rate is forecast to reach 9.1%.

In 2009/10, after continued political and consumer pressure, we are also forecasting some further easing in the variable housing rate during the second half of 2009. With the cash rate on hold, this expectation is based on conditions in global financial markets gradually improving in 2008/09, leading to lower cost of funds for Australian banks. In this environment, by June 2010, the standard variable rate is forecast to be 8.6%.

Nevertheless, inflationary pressures are forecast to persist into the start of the next decade. In particular, a substantial upswing in dwelling construction is expected to develop in 2010 and 2011, due to a very large undersupply of housing. The reduction in housing mortgage rates over 2008/09 and 2009/10 will help contribute to this recovery in dwelling construction. As the labour market remains tight, wage cost inflationary pressures are expected to come to the fore and the standard variable rate should rise to 8.85% in June 2011, as the Reserve Bank tightens monetary policy.

2. Residential Demand



STATE OF PLAY

The rising stock deficiency of dwellings across Australia has led to a pick up in residential prices across most Australian capital cities in 2007/08, except in Sydney and Perth. High net overseas migration is driving strong underlying demand at the national level, whilst increasing the stock deficiency in most states. This strength in demand has resulted in vacancy rates across the country tightening to below the balanced market levels of 3%. The strength in residential markets across Australia was moderated by the considerable rise in interest rates over 2007/08.

The number of first home buyers entering the national residential market remained strong over 2007/08, enticed by expanding first home buyer benefits. Investor demand for residential property however continues to strengthen with loans for investment increasing by 2% in 2007/08. Despite a rising interest rate environment, which has had a significant impact on first home buyers, the tight vacancy rates across Australia and subsequent rising rentals has seen rental yields improve and has supported investor demand.

Although there were four cash rate rises in 2007/08 by the Reserve Bank of Australia, and additional rises from the banks, house prices in all capital cities across Australia, except Perth and Sydney, experienced considerable house price growth in 2007/08. Adelaide (16.7% annual growth to June 2008) and Brisbane (12.5% annual growth to June 2008) in particular witnessed house price increases exceeding that of 2006/07.

Perth was the only capital city that had negative growth during the 2007/08 year, with the median house price declining marginally. The decline in the Perth residential market is consistent with the declines experienced in Sydney and Canberra during 2004/05, when deteriorating affordability impacted demand. Sydney on the other hand, rose marginally for the second consecutive year, rising by 1% in 2007/08.

Further deterioration of home affordability across all capital cities is expected to have the most influential effect on residential market conditions in 2008/09, a direct result of the 1.4% rise in interest rates seen over 2007/08. As a result, house price growth is forecast to be minimal in most capital cities over 2008/09.

In the medium term, Australia's residential market will remain interest rate sensitive. Economic uncertainty will continue to filter through to the Australian economy and affect purchaser sentiment, dampening demand.

However, the underlying fundamentals are expected to remain solid, underpinned by strong population growth and a continuing dwelling deficiency.

In addition, the recent decline of interest rates in September 2008 is expected to continue over calendar year 2009 (falling by a further 0.75%), firstly by the Reserve Bank of Australia and then independently by the banks as the uncertainty surrounding the fallout of international borrowing funds improves. Consequently, we expect further upward momentum to construction and housing prices beyond 2009.

2.1. HOME LOAN ACTIVITY

2.1.1 OWNER OCCUPIER LOAN ACTIVITY

Following the recovery in the number of loans for new dwellings in 2003/04, loans for new and established dwellings nationally edged down in 2004/05. Over the following two years, housing finance for owner occupation strengthened, with the number of loans for established dwellings rising by a total of 19%, while loans for new dwellings rose by a total 14%.

While growth in lending activity continued into the second half of calendar 2007, a significant decline in new home loans in the first half of 2008 has resulted in a total decline for the 2007/08 financial year. This decline has occurred for both new (-6%) and established (-4%) dwellings. The key factor behind this decline has been the interest rate rises that occurred through the year, and the subsequent deterioration of affordability.

While lending activity had already been trending downwards in the Northern Territory and Western Australia in 2006/07, all states and territories generally recorded single digit percentage declines in new home loans in 2007/08—with the exception of Tasmania, where the level of lending activity remained

Table 3: Number of home loans approved for owner occupation - % change on previous year

State	New Dwellings			
	2004/05	2005/06	2006/07	2007/08
New South Wales	-11	9	3	-6
Victoria	0	6	4	-4
Queensland	-11	10	25	-2
South Australia	-5	8	13	-4
Western Australia	7	14	-12	-16
Tasmania	13	-5	-1	0
Northern Territory	46	15	-28	-12
A.C.T.	-14	8	14	-13
Australia	-4	9	5	-6

State	Existing Dwellings			
	2004/05	2005/06	2006/07	2007/08
New South Wales	-10	13	10	-2
Victoria	6	7	8	0
Queensland	-6	13	14	-8
South Australia	6	5	6	-7
Western Australia	13	16	-12	-9
Tasmania	-11	9	11	2
Northern Territory	38	24	-24	-11
A.C.T.	-19	13	31	-3
Australia	-1	12	7	-4

Source: Australian Bureau of Statistics

more or less the same as the previous year. As the most affordable market, the state may be benefiting from interest from other states as affordability on the mainland deteriorated through the year.

Nationally, loans to first home buyers increased significantly in 2004/05 (16%) and 2005/06 (24%) after the low number in 2003/04, which was influenced by the removal of the additional First Home Owner's Grant for new housing and the subsequent drop off in demand (Table 4). Although easing, growth continued in 2006/07, with 131,000 loans approved to first home buyers, representing a mild increase of 2% for the year. This positive, yet easing

of activity by first home buyers in 2006/07 turned into a decline in activity the following year with a drop of 1% to finish at 129,100 loan approvals to first home buyers in 2007/08. Much of this decline has come through in the first half of calendar 2008, led by sustained affordability concerns relating to the increasing cost of finance.

At the state level, the strongest growth in loans to first home buyers over the year to 2007/08 occurred in Western Australia (19%), followed by Victoria (3%), and then Tasmania (3%). The growth in Western Australia is likely to have occurred as a result of stamp duty exemptions to first home buyers

“the strongest growth in loans to first home buyers over the year to 2007/08 occurred in Western Australia (19%), followed by Victoria (3%), and then Tasmania (3%)”



put in place just before the start of the year. Conversely, all the other states recorded falls in the number of loans to first home buyers with the Australian Capital Territory recording the largest fall over the year to June 2008 of 22%—albeit starting from a low base. Additionally, the Northern Territory (-17%), Queensland (-13%), South Australia (-2%) and New South Wales (-1%) all recorded falls in the number of loans to first home buyers for the year to June 2008.

2.1.2 INVESTOR LOAN ACTIVITY

The value of investor loans has recovered since declining by 15% in 2004/05, increasing by a total of 15% over the two years to 2006/07, to total \$69.1 billion. However, over the year to June 2008, loans for investment slowed to grow by only 2% to finish at \$70.5 billion. Additionally, the level of investor

finance was around 36% of total residential purchaser activity in 2007/08, after peaking at 43% in 2003/04.

The slowing growth in 2007/08 has been the result of the substantial growth in property prices between 2000 and 2007, along with recent increases in the cost of finance which has translated into lower yields for investors. In an environment of limited capital growth, this has caused investors to reduce their activity in the property market, and possibly take up an alternative form of investment—such as equities, superannuation, or even fixed interest in the current environment.

In addition, the slowing growth in 2007/08 has been particularly influenced by declines in investor activity in the first half of 2008, underpinned by higher interest rates increasing the gap between rental returns to investors and mortgage repayments. The result has varied

Table 4: Number of loans for first home buyers

State	Annual Average 1998/00 to 2003/04	2004/05	2005/06	2006/07	2007/08
New South Wales	32,582	27,734	36,499	38,986	38,480
Victoria	28,706	28,532	33,255	33,071	34,089
Queensland	23,814	20,130	26,953	31,324	27,361
South Australia	7,478	6,612	7,912	8,443	8,309
Western Australia	15,078	16,328	17,746	13,789	16,445
Tasmania	2,124	1,681	2,220	2,073	2,141
Northern Territory	995	1,485	1,912	1,119	930
A.C.T.	1,834	1,162	1,498	1,792	1,394
Australia	112,610	103,664	127,995	130,597	129,149

Source: Australian Bureau of Statistics

Table 5: Total residential home loan activity

Year Ended June	Loans for Owner Occupation \$million	% Change	Loans for Investment \$million	% Change	Total Home Loan Activity \$million	% Change	Loans for Owner Occupation %	Loans for Investment \$million
1991/92	26,343		4,230		30,573		86.2	13.8
1992/93	32,327	22.7	6,385	50.9	38,712	26.6	83.5	16.5
1993/94	41,249	27.6	10,657	66.9	51,906	34.1	79.5	20.5
1994/95	36,419	-11.7	11,413	7.1	47,832	-7.8	76.1	23.9
1995/96	34,930	-4.1	11,885	4.1	46,815	-2.1	74.6	25.4
1996/97	39,089	11.9	16,496	38.8	55,585	18.7	70.3	29.7
1997/98	44,709	14.4	21,446	30.0	66,155	19.0	67.6	32.4
1998/99	51,157	14.4	21,822	1.8	72,979	10.3	70.1	29.9
1999/00	62,042	21.3	28,458	30.4	90,500	24.0	68.6	31.4
2000/01	59,052	-4.8	27,505	-3.3	86,557	-4.4	68.2	31.8
2001/02	78,215	32.5	43,163	56.9	121,378	40.2	64.4	35.6
2002/03	82,287	5.2	57,653	33.6	139,940	15.3	58.8	41.2
2003/04	92,506	12.4	71,010	23.2	163,516	16.8	56.6	43.4
2004/05	97,846	5.8	60,288	-15.1	158,134	-3.3	61.9	38.1
2005/06	113,523	16.0	32,732	4.1	176,255	11.5	64.4	35.6
2006/07	125,717	10.7	69,046	10.1	194,763	10.5	64.5	35.5
2007/08	127,451	1.4	70,462	2.1	197,913	1.6	64.4	35.6

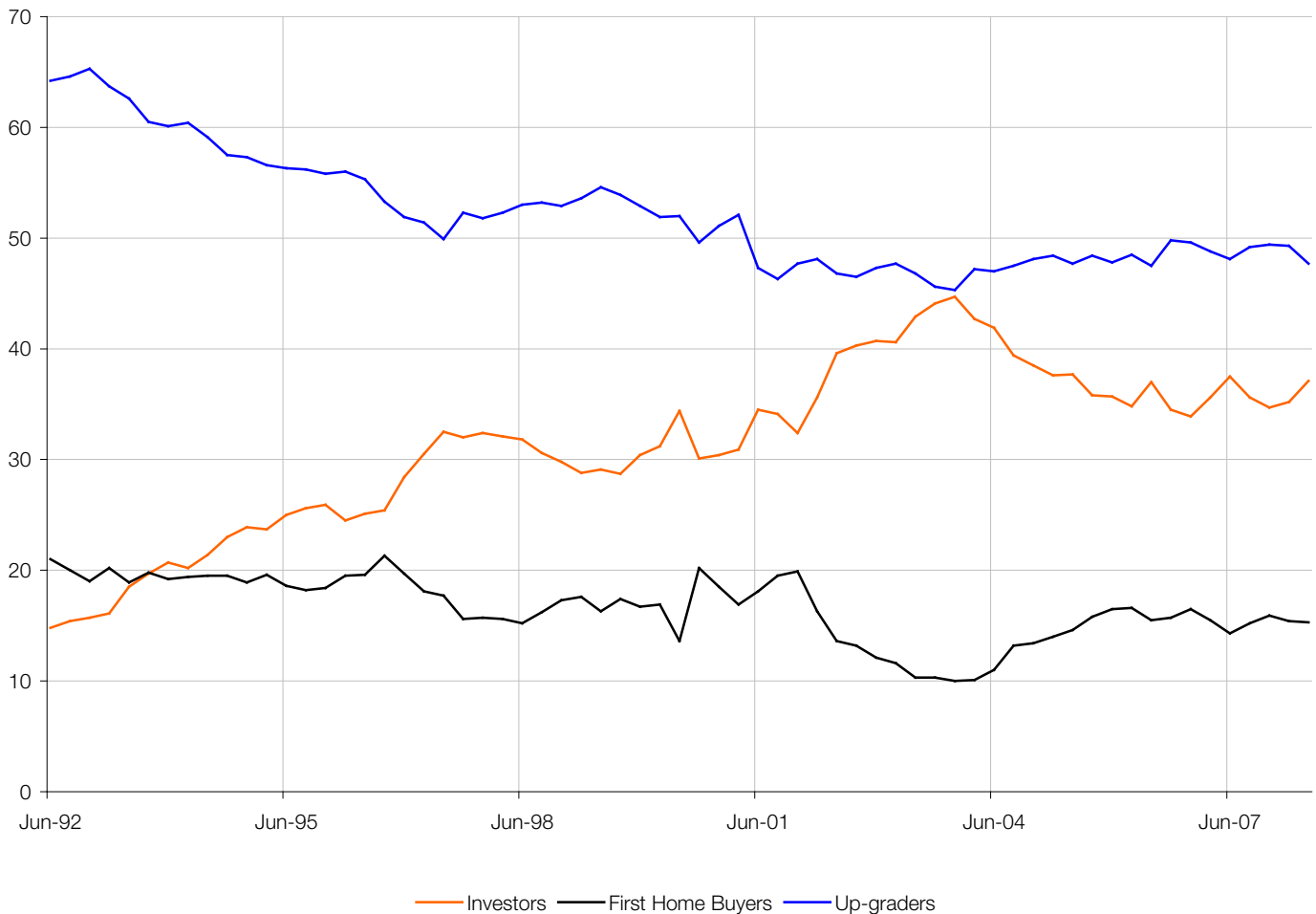
Source: Australian Bureau of Statistics

across the states. For instance investor activity in Queensland increased by 6% for the year to June 2008, down from a 29% increase the previous year. The Northern Territory also suffered with a fall of 8% for the year to June 2008, down from a growth rate of 33% the previous year.

Other states affected at the hands of a contracting financial system and inflated prices, were Western Australia and New South Wales—both down by 9% for the year ending June 2008. Victoria and South Australia bucked the trend with growth rates above that of the previous year, with Victoria recording a 21% increase, while South Australia increased by 19%. Additionally, Tasmania grew in investor activity by 10% for the year to June 2008—up from 7% the previous year. Nevertheless, there has been a slowing trend across the board in the first half of 2008.



Chart 1: Proportion of residential loans attributable to investment property



Source: Australian Bureau of Statistics

“slowing growth in 2007/08 has been particularly influenced by declines in investor activity in the first half of 2008, underpinned by higher interest rates increasing the gap between rental returns to investors and mortgage repayments”



2.2 DEMAND AND SUPPLY

Strengthening overseas migration is expected to be a key driver behind a forecast underlying demand for 185,000 new dwellings per annum across Australia over the five years to 2012/13. This is a significant increase over the estimated new dwelling requirement of 157,200 for the period 2001/02 to 2005/06. The underlying demand compares with only 154,500 new dwellings being commenced in 2007/08.

Net overseas migration is expected to rise sharply from a low of 100,000 in 2003/04 to an estimated 195,000 in 2007/08, followed by an expected increase of 18% in 2008/09, to take the total level of net overseas migration to 230,000.

In 2009/10, economic growth is expected to ease, and as a consequence, net overseas migration is projected to weaken slightly to 200,000 persons. It is

forecast that net overseas migration will average around 196,700 people per annum for the three years to 2010/11, significantly higher than the average of 148,600 over the five years to 2007/08—which will underpin the higher underlying demand.

New dwelling supply has been unable to respond to the stronger demand and, as a result, a significant undersupply of housing has developed. New dwelling commencements peaked at 172,400 in 2003/04, and have since been on a downward trend, declining by an estimated 12% in the four years to 2007/08 to reach 154,500. The growth in house and unit/apartment prices over the past five years, along with sustained higher interest rates and substantially higher finance costs have resulted in an overall drop in dwelling commencements, with solid falls in both private house starts and private other dwelling starts.

Australia's stock deficiency is estimated to have increased from

39,300 dwellings at June 2007 to 56,500 dwellings by June 2008—as underlying demand continued to accelerate during the year, while total dwelling completions showed a modest decline.

The majority of Australia's stock deficiency at June 2008 is located in New South Wales, Victoria and Queensland, with the three states accounting for an extraordinarily high 102% of the national total—only being brought back under the overall total by stock excess dwellings in Tasmania (1,500 dwellings) and South Australia (1,400 dwellings).

At June 2008, the stock deficiency in New South Wales and Queensland was equivalent to just under half of the respective states' annual underlying demand. Nationally, the stock deficiency is forecast to continue to increase to 2010/11, with strong underlying demand continually outpacing rising dwelling construction.

Table 6: Deficiency of stock and building activity

State	Demand for Housing				Building Activity			
	Deficiency of Stock (estimate)			Average Annual Underlying Demand for Dwellings (2008/09 to 2012/13)	Dwelling Commencements			
	Number of Dwellings ('000)*		June '08 of Average Annual Underlying Demand		2007/08 (estimate)		2008/09 (forecast)	
	As at June '07	As at June '08			Number	Annual % Change	Number	Annual % Change
New South Wales	16.6	30.4	61	50,134	30,120	0.9	30,983	2.9
Victoria	7.5	10.9	24	46,125	41,905	8.4	42,358	1.1
Queensland	16.4	16.2	36	45,213	42,574	3.5	42,546	-0.1
South Australia	-0.3	-1.4	-12	12,005	11,951	6.8	12,548	5.0
Western Australia	-0.1	0.7	3	25,034	21,557	-13.1	21,151	-1.9
Tasmania	-0.1	-1.5	-68	2,246	2,896	1.1	2,701	-6.7
Northern Territory	-0.1	0.5	31	1,696	1,091	-20.0	1,282	17.5
A.C.T.	0.0	0.7	27	2,437	2,395	3.7	2,468	3.0
Australia	39.3	56.5	31	184,889	154,490	1.5	156,038	1.0

Source: BIS Shrapnel

* A negative means stock surplus
Dwelling commencements include conversions

2.2.1 RENTALS

Rental growth in Melbourne and Sydney fell below the rate of inflation after 2000, as vacancy rates crept up past the 3% mark (the balanced market level). Since 2003, vacancy rates in Sydney and Melbourne have tightened, driving higher rental growth. In the year to June 2008, both Sydney (7%) and Melbourne (6%) achieved record rental growth rates, along with vacancy rates dropping to all time lows of 1.1% and 1% respectively.

The strongest rental growth over the year to June 2008 was Perth with a growth rate of 13%—following on from 10% growth the previous year. Interestingly, vacancy rates in Perth have been increasing since 2005/06, and are now nearing the balance market level of 3%—with Perth sitting at 2.8% at June 2008. Additionally, out of all the capitals,

Brisbane has achieved an upward trend in rental growths since 1996/97 to finish at over 9% by the year to June 2008.

Adelaide has maintained a steady rental growth rate since 2000/01 with growth rates remaining within 3-5% to June 2008. Additionally, vacancy rates have also remained within a narrow band of less than 1% (between 1.3% and 1.9%) for the five years to June 2008. Furthermore, Darwin has also shown a robust rental growth rate to improve from a fall of 3% by June 2000, to record a healthy rental growth rate of 9% by June 2008.

Canberra has also managed to increase its rental growth from a modest 3% in 2004/05 to record a rental growth rate of 7% by June 2008—similar to the outcome achieved in 2003/04. Likewise, Hobart had shown solid rental growth over the five years to 2006/07, recording a growth rate above that of the growth rate of

inflation. However for the year to June 2008, rental growth rate (4.3%) fell below that of inflation, and also grew at a slower yearly rate than the previous two years.



“In the year to June 2008, both Sydney (7%) and Melbourne (6%) achieved record rental growth rates, along with vacancy rates dropping to all time lows of 1.1% and 1% respectively”

Table 7: Annual rental growth and vacancy rates

As at June Quarter	Sydney		Melbourne		Brisbane		Adelaide		CPI Growth (%)
	Rental Growth (%)	Vacancy Rate (%)	Rental Growth (%)	Vacancy Rate (%)	Rental Growth (%)	Vacancy Rate (%)	Rental Growth (%)	Vacancy Rate (%)	
1997	4.0	2.3	3.6	2.0	0.6	4.2	1.0	2.6	0.3
1998	4.3	2.6	4.0	1.7	0.5	4.7	1.7	1.9	0.7
1999	3.8	1.8	2.2	3.6	0.6	5.4	1.9	2.5	1.1
2000	4.2	2.2	2.9	3.5	0.9	5.2*	2.1	4.5	3.2
2001	4.2	3.3	2.6	3.9	2.2	2.2*	2.9	3.6	6.0
2002	2.5	4.6	2.6	3.8	2.4	4.1	3.0	3.6	2.8
2003	0.4	4.4	1.7	3.9	3.5	2.3	3.7	2.8	2.7
2004	2.2	3.6	1.6	3.6	4.6	2.3	3.0	1.9	2.5
2005	1.4	2.5	1.5	2.6	4.4	2.3	2.8	1.8	2.5
2006	2.0	2.1	1.5	1.7	6.2	2.2	3.6	1.6	4.0
2007	4.2	1.4	4.1	1.4	6.6	1.5	4.0	1.3	2.1
2008	7.1	1.1	6.2	1.0	9.3	2.2*	4.9	1.5	4.5

As at June Quarter	Perth		Hobart		Canberra		Darwin		CPI Growth (%)
	Rental Growth (%)	Vacancy Rate (%)	Rental Growth (%)	Vacancy Rate (%)	Rental Growth (%)	Vacancy Rate (%)	Rental Growth (%)	Vacancy Rate (%)	
1997	1.4	2.7	1.3	6.2	-1.0	4.3	2.0	5.8	0.3
1998	1.4	2.5	-0.4	6.9	-1.5	2.9	0.8	14.1	0.7
1999	1.9	2.4	-0.3	8.3	0.8	1.0	0.1	14.1	1.1
2000	2.3	3.0	0.2	4.1	5.7	2.3	-2.9	6.4	3.2
2001	1.7	4.2	2.2	2.0	4.2	3.0	-0.6	9.0	6.0
2002	2.0	4.5	2.4	2.3	5.7	3.6	0.2	5.0	2.8
2003	1.3	4.5	3.1	2.8	4.9	3.5	1.1	7.1	2.7
2004	2.6	3.3	5.0	2.2	7.4	4.3	1.9	5.5	2.5
2005	2.3	2.5	3.3	2.5	3.0	2.2	3.2	1.9	2.5
2006	4.7	1.9	5.1	2.2	2.9	2.3	4.4	2.4	4.0
2007	9.6	2.1	5.5	2.3	5.4	2.4	8.0	1.2	2.1
2008	12.5	2.8	4.3	2.3*	7.4	0.5*	8.7	2.0*	4.5

Source: Australian Bureau of Statistics and Real Estate Institute of Australia

* Figures at March quarter

2.3 TRENDS IN MIGRATION

2.3.1 NET OVERSEAS MIGRATION

Net overseas migration is a major component of growth in Australia's population and consequently in new household formation, which in turn, is the key driver of underlying demand for new dwellings.

Australia's net overseas migration peaked in 2000/01 as a result of significant growth in the number of long-term arrivals and a modest rise in the number of permanent settlers, before easing to a low of 100,000 in 2003/04. Since then, the Federal Government has continually increased the official overseas migration intake in response to low unemployment and emerging skills shortages. Similarly, the number of long-term arrivals has also increased as the number of migrants on various working visas increased, and overseas student numbers increased. Net overseas migration into Australia has steadily increased to 177,600 persons in 2006/07, and is estimated to have risen in 2007/08 to 195,000 persons, although the latest data for March quarter 2008 suggests that there is further upside to this estimate. Increases in the official intake announced in the May 2008 Federal Budget, as well as the speeding up of processing of temporary working visas, suggest further significant rises in 2008/09.

Consequently, net overseas migration is forecast to continue to grow over 2008/09 to reach 230,000 persons. However, it is anticipated that the impact of easing economic growth will be felt over 2009/10, which will drop the level of migration to an estimated 200,000 persons. With a slowdown in economic activity, it is likely to result in lower inward migration, and a higher



outflow of long-term visitors, due to employment opportunities diminishing.

The easing of migration levels is expected to continue through to 2010/11 with a further fall of 17% to reach 160,000 persons. The anticipated slowdown in migration levels in the second half of the forecast period is expected to result in the net overseas migration inflow averaging 196,700 persons per annum for the three years to 2010/11, up from an annual average of 148,600 between 2003/04 to 2007/08.

New South Wales is expected to be the initial location for 30% of overseas migrants over the next three years. While this is high relative to other states, it is well below the 45% to 46% share of the mid 1990s.

Other states' expected share of Australia's overseas migration intake in the forecast period is 27% for Victoria, 21% for Queensland, 15% for Western Australia, and 7% for South Australia. Tasmania, the Northern Territory and the Australian Capital Territory proportion of the total overseas migration inflow is projected to be less than 1% in the four years to 2010/11.

The state capitals absorb the majority of each state's overseas migrants. For example, Sydney receives over 90% of New South Wales' overseas migrants, while over 90% of Victoria's overseas migrants end up in Melbourne. The exception is in Queensland, where around 60% of overseas migrants go into Brisbane, although a total 85% go into total South East Queensland overall.

Table 8: Net overseas migration ('000s)

Year Ended June	New South Wales	Victoria	Queensland	South Australia	Western Australia	Tasmania	Northern Territory	A.C.T.	Australia
1997	37.3	21.1	12.6	3.1	12.3	0.3	0.5	-0.1	87.1
1998	31.8	19.3	12.5	3.2	12.0	0.0	0.6	-0.2	79.2
1999	41.1	24.7	13.7	2.7	13.4	0.2	1.0	-0.2	96.5
2000	43.7	27.0	17.5	3.8	14.0	0.4	0.9	-0.1	107.3
2001	58.6	35.3	21.0	2.8	16.3	0.1	0.9	0.7	135.7
2002	44.4	20.3	26.5	2.8	15.0	0.3	0.7	0.7	110.6
2003	40.9	26.8	27.1	3.9	15.6	1.0	0.3	0.9	116.5
2004	29.8	25.0	25.4	4.3	13.6	0.7	0.6	0.5	100.0
2005	35.2	32.3	29.6	7.0	17.2	1.0	1.0	0.5	123.8
2006	38.5	39.6	33.0	9.8	22.4	1.2	1.9	0.5	146.8
2007	54.9	47.2	33.5	13.1	25.5	1.3	1.3	0.8	177.6
Forecast									
2008	57.5	51.7	40.0	13.7	28.5	1.4	1.4	1.0	195.0
2009	67.9	61.0	47.2	16.1	33.6	1.6	1.6	1.2	230.0
2010	59.0	53.0	41.0	14.0	29.2	1.4	1.4	1.0	200.0
2011	47.2	42.4	32.8	11.2	23.4	1.1	1.1	0.8	160.0

Source: Australian Bureau of Statistics and BIS Shrapnel

2.3.2 NET INTERSTATE MIGRATION

The dominant interstate flow in recent years is generally the movement of population from New South Wales to Queensland. This is largely due to the higher level of Sydney house and land prices, which encourage the exodus of first home buyers and families who are priced out of the Sydney market, as well as 'empty nesters' and 'retirees' to cash in on significant capital gains in their property and pocket the difference when moving to more affordable markets. This outflow peaked at a net movement from New South Wales of 32,700 in 2002/03.

However, with house prices in Brisbane and Queensland outperforming Sydney since then, the affordability advantage has narrowed significantly, and the net outflow from New South Wales has settled at around 25,000 per annum in the last three years. However, improving conditions in New South Wales and Sydney are expected to see a further reduction in the state's

net outflow to 16,000 persons by 2009/10.

Victoria's net interstate migration inflow slowed to more or less zero in 2002/03 after averaging 3,400 persons per annum between 1997/98 and 2001/02. Since then, the state has experienced a modest net outflow of around 2,000 to 3,000 persons. This is expected to increase slightly to an average 4,300 persons per annum over the three years to 2010/11, as residents continue to move interstate for employment opportunities in the booming resource states, or opt for more affordable housing in other parts of the country.

The price advantage of residential property and the more attractive climate and lifestyle offerings in South East Queensland provided the catalyst for a rise in the net inflow into Queensland to 38,400 in 2002/03. However, migration into the state has eased to an estimated 26,000 in 2007/08, as the strong price growth across the state has decreased its affordability advantage. Nevertheless, a robust Queensland economy is likely

to counter this declining trend somewhat, with only a modest further decline to 24,500 persons by 2009/10, before picking up once more in 2010/11 to 27,000 persons—arguably due to the first lot of baby boomer retirees heading for a coastal retirement as the residential market in the other states begins to improve and encourage the trading down of their existing dwellings.

South Australia's net interstate migration outflow reached its best level of 1,200 in 2002/03, although has since increased to oscillate at an outflow of around 3,000 per annum. The net interstate migration outflow from South Australia is forecast to remain roughly at 3,000 persons per annum throughout the forecast period to 2010/11.

Western Australia sustained four consecutive years of net interstate migration outflows up to, and including, 2002/03, and has now reverted to a rising net inflow, largely due to the strong job prospects resulting from the state's surge in mining activity.

“The dominant interstate flow in recent years is generally the movement of population from New South Wales to Queensland. ”

The net inflow of 4,400 persons in 2006/07 is estimated to have increased to 5,000 persons in 2007/08. However, as the boom in mining investment begins to ease and economic conditions weaken, the net interstate migration inflow is forecast to moderate in 2008/09 to 3,000 persons and fall to 1,000 persons per annum over the two years 2010/11.

After experiencing a net inflow of interstate migrants over 2002/03 to 2004/05, primarily from empty nesters and retirees moving to downshift, a modest new outflow has returned. It is anticipated that Tasmania will average an outflow of 900 persons per annum throughout

the forecast period to 2010/11, with more attractive relative affordability to older potential residents offsetting outflows of younger residents leaving for employment.

After recording consistent net outflows over 1997/98 to 2003/04, the Northern Territory has more or less experienced a balanced net interstate migration position over the following four years. This is expected to be the case over the three years to 2010/11, with investment in the resources sectors continuing to be a positive for interstate migration.

The Australian Capital Territory recorded a significant turnaround in net interstate migration in 2005/06.

After posting net interstate outflows in the four years to 2004/05, the Australian Capital Territory recorded an inflow of 300 persons in 2005/06. Strong growth in Federal Government employment influenced the reversing trend in net interstate migration resulting in the Australian Capital Territory's inflow of interstate migrants increasing to 1,900 persons in 2006/07. In line with weaker economic conditions, this figure is projected to ease to 500 persons in 2007/08, and to slow further in 2008/09 (zero persons) and 2009/10 (-1,000 persons), before improving slightly in 2010/11 (-500 persons).

Table 9: Net interstate migration ('000s)

Year Ended June	New South Wales	Victoria	Queensland	South Australia	Western Australia	Tasmania	Northern Territory	A.C.T.
1997	-10.7	-6.2	19.6	-3.3	4.7	-3.3	1.8	-2.5
1998	-12.2	-0.3	17.4	-2.0	3.2	-3.6	-0.5	-2.0
1999	-13.1	2.5	16.7	-1.6	0.3	-3.3	-1.0	-0.5
2000	-14.3	5.2	18.5	-3.5	-2.2	-2.6	-0.9	-0.1
2001	-16.3	5.2	20.0	-2.4	-3.1	-2.1	-1.6	0.4
2002	-24.4	4.4	31.2	-1.6	-4.4	-1.5	-2.6	-1.0
2003	-32.7	-0.8	38.4	-1.2	-2.0	2.0	-2.7	-0.8
2004	-31.3	-3.1	35.9	-2.9	2.1	2.6	-1.4	-1.6
2005	-26.5	-3.1	30.7	-3.3	2.2	0.3	0.7	-0.9
2006	-24.6	-1.5	25.2	-2.6	4.0	-0.2	-0.7	0.3
2007	-27.3	-2.2	27.0	-3.6	4.4	-0.5	0.2	1.9
Forecast								
2008	-25.0	-3.0	26.0	-3.0	5.0	-0.5	0.0	0.5
2009	-21.0	-3.0	25.5	-3.0	3.0	-1.0	-0.5	0.0
2010	-16.0	-4.0	24.5	-3.0	1.0	-1.0	-0.5	-1.0
2011	-17.5	-6.0	27.0	-3.0	1.0	-1.0	0.0	-0.5

Source: Australian Bureau of Statistics and BIS Shrapnel

3. Sydney

3.1 STATE OF PLAY

The Sydney residential market stabilised over 2006/07 and 2007/08, after a significant decline in the median house price over 2004/05. The demise of housing construction to a 50 year low has aided a resurgence in Sydney's stock deficiency, which has pushed vacancy rates to historic lows and contributed to significant rises in rents across Sydney.

Sydney's median house price rose by 52% over the three years to June 2004. A deficiency of dwelling stock had emerged, and combined with falling interest rates had underpinned the surge in price growth. In particular, the increase in demand was fuelled by a phenomenal rise in investor demand. Investors ignored the weak share market, flooding the residential property sector, with expectations that strong capital gains would be sustained and compensate for the rapidly deteriorating rental yields.

This rise in prices resulted in a rapid deterioration of housing affordability. Between June 2001 and June 2004 mortgage repayments for 75% of the median house price increased from 47% to 65% of monthly earnings. This was the worst level since 1988/89 and 1989/90 when median house prices rose by a total of 98% over the two years to June 1989 and interest rates peaked at 17%.

Consequently, underlying demand in New South Wales began to weaken—evident in Sydney's median house price growth, which slowed to 6.4% over 2003/04, and was \$552,000 at June 2004.

This was ultimately to be the peak in what had been a substantial rise in the median house price. The deterioration of affordability drove potential buyers out of the market, increasingly opting to stay at home longer, rent or move to a more affordable part of the country. Consequently, with little pressure on prices in the market, and Sydney's median house price declined by 4.3% the following year, to \$528,000 in June 2005.

In 2005/06, the median house price stabilised, declining by just under 1%, as demand shifted. Sydney's interstate migration loss eased and with overseas migration into Sydney rising, a deficiency of dwellings emerged. Combined with continued declines in dwelling construction across Sydney, upward pressure on rentals in the inner ring of Sydney began impacting on price growth, leading to pockets of price rises. This continued into 2006/07, with the median house price increasing by less than 1%.





“Dwelling construction, particularly for new houses, has fallen to levels not seen since the 1950s, and with demand well exceeding supply, the stock deficiency is rapidly increasing”

Dwelling construction, particularly for new houses, has fallen to levels not seen since the 1950s, and with demand well exceeding supply, the stock deficiency is rapidly increasing. This situation is largely a consequence of the limited land supply that has resulted in owner occupiers being priced out of the market for new detached dwellings.

Over 2007/08, Sydney's stock deficiency rose to a year's worth of underlying demand. However, the effects of considerable rises in interest rates (1.4% rise in the standard variable rate in the year to June 2008), particularly toward the

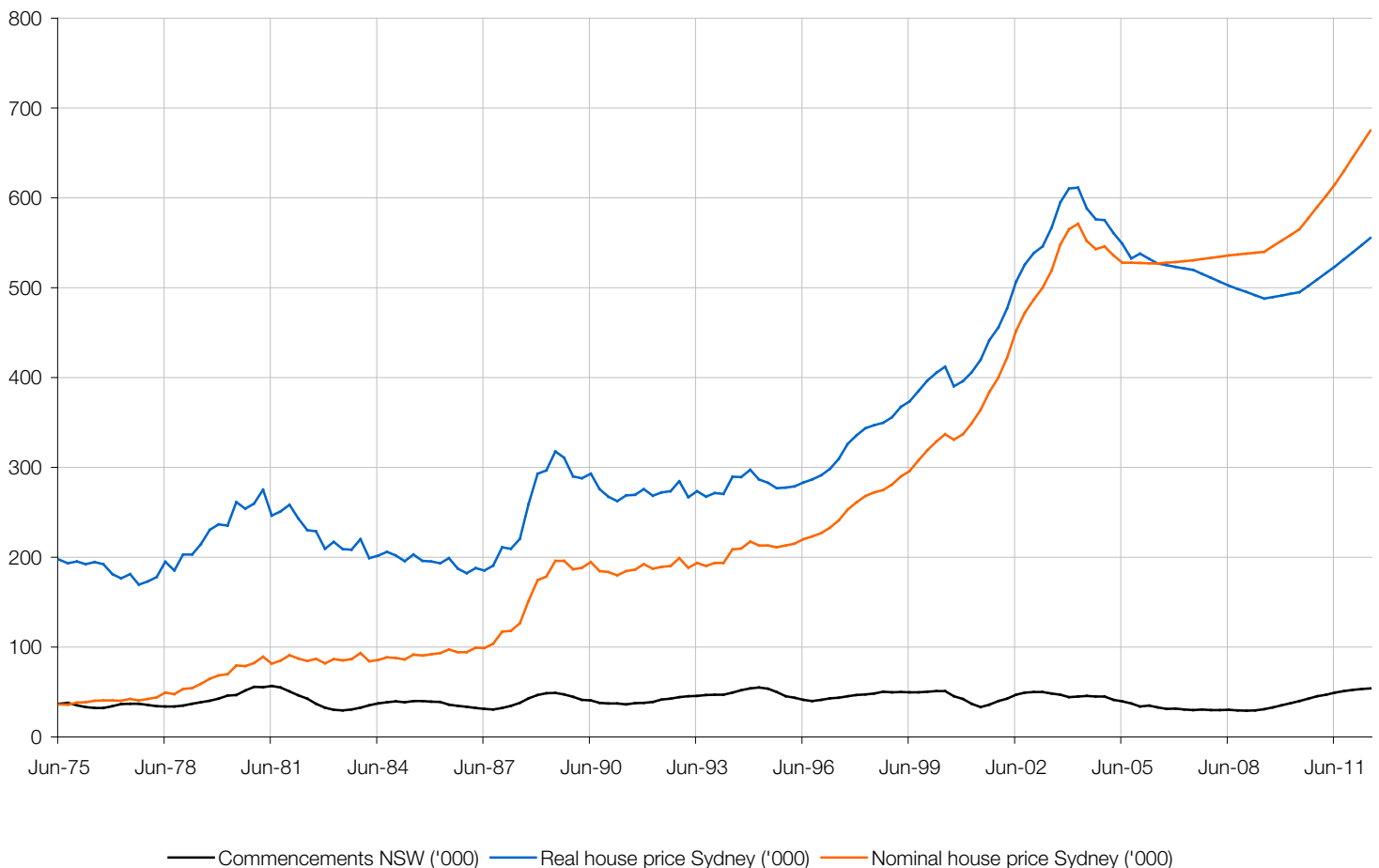
latter half of 2007/08, slowed price growth in Sydney to less than 1% annual growth.

The key emerging issue continues to be the tightness of the rental market. Residential vacancy rates across Sydney have tightened considerably since peaking at 4.6% in June 2002. Strong underlying demand for dwellings and an escalating stock deficiency (as a result of dwelling construction falling to historic lows) has underpinned this improvement in the rental market.

In addition, the significant price growth that was witnessed over

the 2001–2004 period, combined with the current rising interest rate environment, has facilitated a large shift of owner occupier demand into the rental market, as affordability was strained. By June quarter 2008, vacancy rates had fallen to below 1.1% across Sydney, and rental growth has quickly pushed up to an annual rate of 7%.

Chart 2: Sydney Dwellings - Prices and Activity



Source: Australian Bureau of Statistics, BIS Shrapnel and Real Estate Institute of Australia.

3.2 FORECAST

In the short-term, Sydney's residential property market will remain interest rate sensitive. In September 2008, the Reserve Bank of Australia lowered interest rates for the first time in seven years in an effort to improve confidence after the marked deterioration in economic conditions and the uncertainty surrounding the cost of global credit funds. Interest rates are forecast to fall a further 0.25% in early 2009 as the RBA continues to respond to weakening consumer and business confidence.

Despite the decline in interest rates and pressure from a tightening rental

market, affordability constraints and current negative sentiment in Sydney will limit price growth in 2008/09 to less than 1%.

In 2009/10, the variable housing rate is forecast to fall further, independently of the Reserve Bank of Australia, as the decreased cost of credit is subsequently passed on to consumers with the easing of the cost of funds. With house prices now underpinned by both falling interest rates, improved housing affordability and a rising stock deficiency, which has tightened vacancy rates and spurred solid rental growth, Sydney's median house price is forecast to increase by 5% in 2009/10.

Lower housing interest rates should provide some impetus for both

owner-occupiers and investors to return to the property market in greater numbers. Underpinned by the rising housing deficiency, which is forecast to peak at over a year's worth of underlying demand by 2010, and improved rental yields, this environment will spur an improvement in sentiment across Sydney.

After five years of significant rental growth, and the stabilisation of interest rates, Sydney's median house price is expected to rise by a further 9% in the year to June 2011 to a median of \$615,000.

4. Melbourne

4.1 STATE OF PLAY

House price growth moderated over the three years to 2005/06, rising by an annual average of 1.5% to \$371,100 at June 2006. This included a decline in prices in 2004/05 as demand softened due to the previous sizeable price growth. Also, high levels of construction during the upturn led to an increased number of dwelling completions from 2003/04 onwards, which eroded some of the pent-up demand that had emerged. Consequently, stock deficiency levels eased to an annual average of just over 2,000 dwellings in the three years to June 2006, from a peak of 4,800 dwellings at June 2002.

However, an underlying increasing trend was beginning to emerge. Loans to first home buyers increased by 17% in 2005/06, with the increase in activity from this segment of the market likely to have had some positive effect on house prices, by providing a market for upgraders to sell into. There was also strong growth in loans by owner occupiers for newly erected dwellings.

In 2006/07, some of the property market indicators suggested continued momentum in house price growth. Underlying demand in Melbourne increased solidly to 33,600 dwellings in the year to June 2007, while total completions fell to 28,000 dwellings, in response to the lower levels of building activity occurring after the residential property boom in Melbourne ended in 2003. As result, Melbourne's modest stock deficiency level at June 2006 grew sizeably to 7,000 dwellings at June 2007.

The dwelling shortfall was highlighted through tight vacancy rates across Melbourne over 2006/07, which hovered around 1.5% (half the balanced market rate) for most of year. These tight conditions enticed investors back to the market, as opportunities for both capital and rental growth improved, with the value of loans to investors rising by 10% in 2006/07, after two years of declining investor demand. With demand from owner occupiers also displaying growth, house prices in Melbourne increased by 11.8% in 2006/07 to \$415,000.

Demand for residential property in Melbourne remained strong in the second half of 2007, despite interest rates increasing twice during this period, causing a further deterioration in housing affordability after solid price growth in 2006/07. Melbourne's median house price peaked in December quarter 2007 at \$472,300, representing 20% growth for the year. Although, these two interest rate rises, plus the three previous rises in May, August and November 2006 appear to have



“the median house price in Melbourne eased to \$451,000 in June quarter 2008”

created a division in price growth between the inner and middle suburbs and outer suburbs within Melbourne in the eighteen months to December 2007. This “two-tiered” market has been evident in the quartile values. Although Melbourne’s lower quartile value increased by 21% from June 2006 to December 2007, this was significantly below the 34% price growth achieved by houses in the upper quartile over the same period.

However, two more interest rate rises in the first six months to June 2008, in addition to further rises by banks in housing variable rates, has seen demand for residential property fall away during this period, with loans to owner occupiers and investors both contracting. As a result, the median house price in Melbourne eased to \$451,000 in June quarter 2008. Although growth for 2007/08 was still solid at 8.7%, all of this growth occurred in the first half of the financial year.

4.2 FORECAST

Over the next three years, the key influences on Melbourne’s median house price growth are expected to be solid rising rents, due to

Melbourne’s housing market being undersupplied, and challenging housing affordability. Median house price growth of 22% over the two years to 2007/08, combined with a 1.9% rise in housing variable rates during that period, has seen affordability deteriorate sharply. This would represent the poorest level affordability has reached since June 1990.

As a result, the constraint of affordability is anticipated to have a greater influence on residential property demand in Melbourne. Price growth is forecast to ease to 2% in 2008/09, lifting the median house value to \$460,000. However, with price growth remaining weak

and the RBA reducing interest rates by 0.25% in September 2008, plus another 0.25% fall forecast in first half 2009, affordability is projected to improve during 2008/09. Furthermore, we are expecting the major banks, independent of the RBA, to lower mortgage rates in 2009/10 as their cost of finance decreases, in line with improving global credit markets. This should provide stimulus for solid house price growth to begin in 2009/10.

High inflows from overseas migration, which is expected to support robust levels of underlying demand (averaging 38,200 dwellings per annum over the forecast years), is likely to place further upward

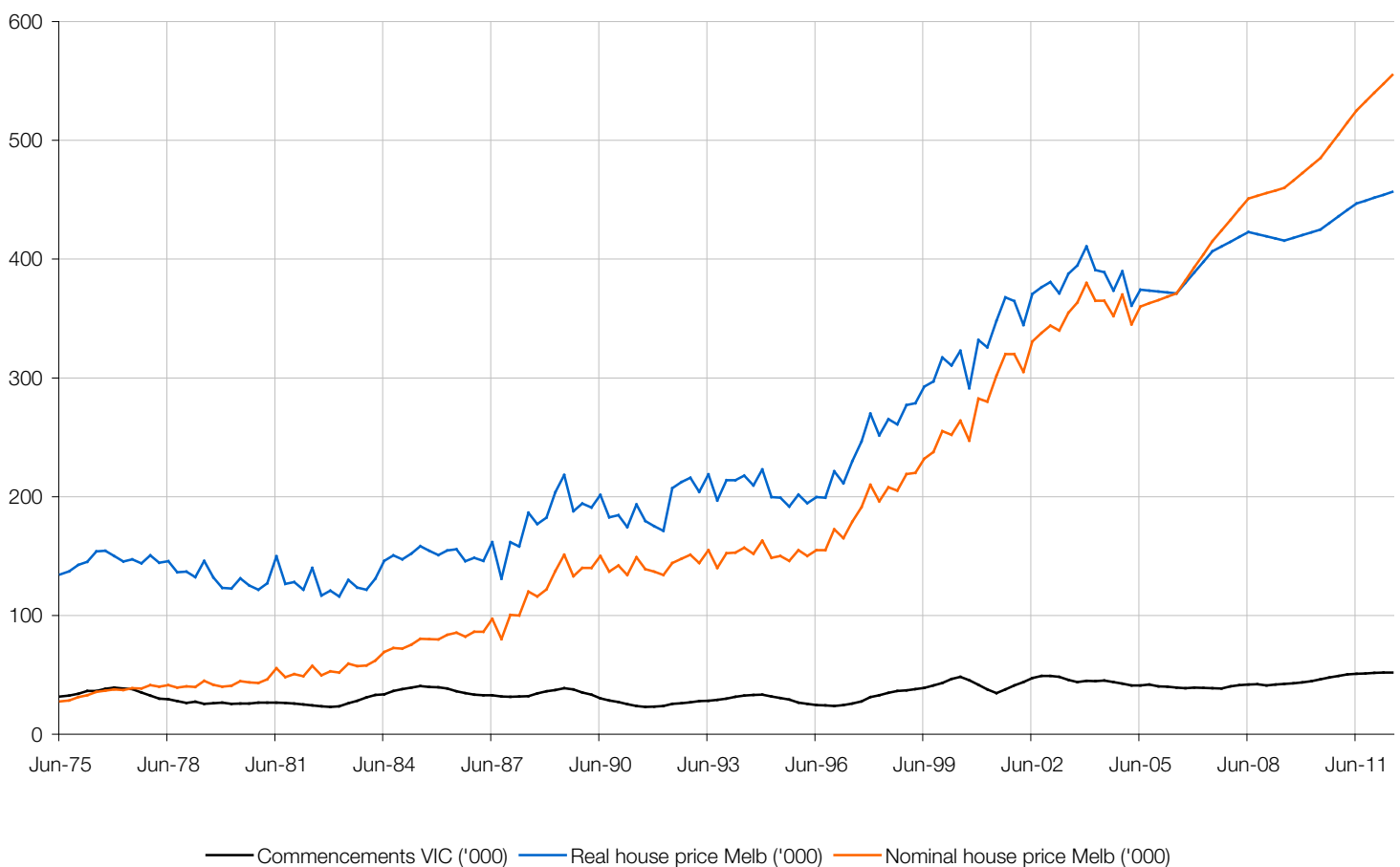


pressure on house prices, especially as demand continues to outpace supply in Melbourne's already tight housing market. This strength in demand is forecast to drive price growth of 5.4% for houses in 2009/10.

By 2010/11, dwelling investment is expected to enter a major recovery period, despite a 0.25% rise in the cash rate expected toward the end of 2010/11, as growth in residential construction boosts economic growth. In addition, the

three bedroom median weekly rental rate in Melbourne is forecast to rise by 23% over the three years to 2010/11, a direct result of the tight vacancy rates and low levels of dwelling completions, which will provide further impetus to investor demand in the residential market. Subsequently, the median house price in Melbourne is forecast to increase by 8.2% for the year, to \$525,000. Total price growth in Melbourne over the three years to 2010/11 is forecast to be 16%, or an increase of 6% in real terms.

Chart 3: Melbourne Dwellings - Prices and Activity



Source: Australian Bureau of Statistics, BIS Shrapnel and Real Estate Institute of Australia.

5. Brisbane



5.1

State of Play

The rise in Brisbane residential property prices over 2001 to 2004 reduced affordability to levels not seen since the end of the 1980s and on a level considerably closer to that of Melbourne (which has typically been less affordable). As a result, the interstate migration inflow began to weaken from 2004/05, and underlying demand also eased, causing the growth in Brisbane's median house price to slow to only 2.5% in 2004/05.

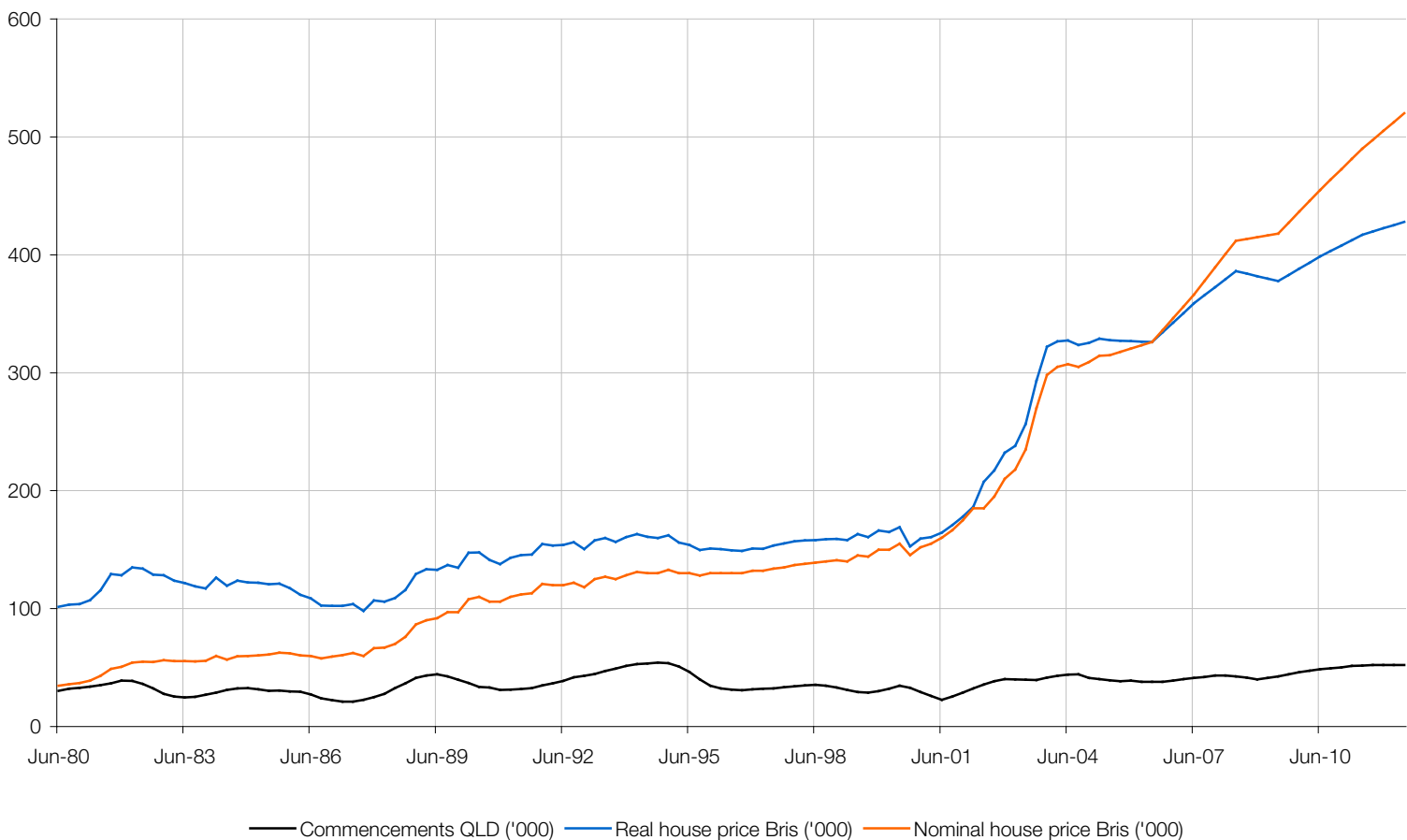
Lending activity rebounded in 2005/06, with a 13% rise in loans to owner occupiers and 5% increase in investor finance. However, the slowing trend was maintained in 2005/06, with affordability continuing to have a dampening effect on house price growth, whilst also lowering interstate migration and slowing underlying demand. This ensured moderate price growth of 3.5% in the year to June 2006, taking the median house price to \$326,000.

After the pause in price growth over 2004/05 and 2005/06, strong wages growth in this period suggests that affordability has steadied in 2006/07. This is reflected in the 16% rise in loans for owner occupation and 17% increase in loans to first home buyers during the 2006/2007 year. In addition, with rental growth also outpacing price growth in the two years to 2005/06, rental returns improved slightly, which drove a 29% rise in investor finance over 2006/07.

Despite net interstate migration easing, net overseas migration was high in a long term sense, at 33,500 persons over 2006/07. This supported an improvement in underlying demand, which was above dwelling completions during the year, resulting in the stock deficiency in Queensland increasing to a considerable 16,400 dwellings as at June 2007. The growing tightness in Brisbane's housing market was highlighted by a vacancy rate of around 1.5% throughout 2006/07. Stronger demand and lending activity underpinned a solid rise of 12.4% in the median price in 2006/07, which reached \$366,300 at June 2007.

With variable housing interest rates increasing by a total of 1.4% in 2007/08, on top of solid house price growth in 2006/07, affordability has deteriorated in Brisbane. This has been reflected by a slowing of growth in investor finance and a declining number of loans to owner occupiers in 2007/08. However, vacancy rates remained below the balance market rate of 3% during the year, which suggests a continued tightness in the Brisbane market, with robust demand being driven by migration. This is placing upward pressure on house prices, evident by further price

Chart 4: Brisbane Dwellings - Prices and Activity



Source: Australian Bureau of Statistics, BIS Shrapnel and Real Estate Institute of Australia date.

growth of 12.5% in 2007/08, lifting Brisbane's median house value to \$412,000.

5.2 Forecast

Underlying demand in Queensland is expected to remain high over the forecast period, benefiting from the continued strong net inflows of migrants. Becoming more prevalent, net overseas migration into Queensland is projected to average 40,300 persons per annum in the three years to 2010/11. Net interstate migration will also be solid at an annual average of 25,700 persons during the forecast period. Consequently, underlying demand

is expected to increase from an annual average of 40,800 dwellings over the two years to 2007/08, to 45,200 dwellings from 2008/09 to 2010/11. With dwelling completions forecast to total 42,400 in 2008/09, new dwelling supply will fall below underlying demand, causing the stock deficiency to increase again from its already high level to 19,000 dwellings at June 2009.

However, the tightness in Brisbane's housing market is not expected to be severe enough to combat the steep deterioration in affordability over 2007/08. At June 2008 it is estimated that the median mortgage repayment, as a share of median income, was 54.8%—which is above the previous high at June 1990. As a result, house price growth in Brisbane is forecast to be a marginal

1.5% in 2008/09, in a clear sign that affordability has reached a ceiling. Price growth is forecast to pick up again to 8.9% in 2009/10, and increase by a further 7.7% in 2010/11. The projected 0.5% fall in interest rates over 2008/09, combined with further wages growth will underpin improved affordability and purchaser confidence. This will be supplemented by a cyclical economic upturn coming through 2010–2011. Brisbane's forecast median house price of \$490,000 by June 2011 represents a total rise of 19% over the 2008 to 2011 period, or an 8% increase in real terms. Cumulative price growth in Brisbane is forecast to be the strongest of the state capital cities covered by this report.

6.1 STATE OF PLAY

The stock surplus in South Australia was completely absorbed by June 2002, with a stock deficiency emerging and growing to peak at 1,600 dwellings at June 2004. Stronger demand for residential property between 1999 and 2004 led to Adelaide's median house price increasing by 100% during this period, from \$125,000 to \$250,000.

High demand during the early 2000s led to increased building activity. With many of these dwelling commencements coming on line from 2003/04, dwelling completions equalled demand in that year, before surpassing it in each of the following two years. This eroded the stock deficiency by June 2006 and placed less upward pressure on house prices, evident by the median house value experiencing no growth over the course of the 2005 calendar year. Although solid, house price growth eased to 10% in 2004/05, before slowing further to 4.4% in 2005/06, which increased the median value to \$287,000 at June 2006.

Following the weakening growth in median house prices in Adelaide over 2005/06, price growth accelerated again, increasing by 9% in 2006/07 and 16% in 2007/08. This was attributed to further improving inflows from overseas migration driving higher population growth and underpinning significant levels of underlying demand. In 2003/04, the net overseas migration inflow was 4,300 persons, however, this inflow has trebled to 13,100 persons in 2006/07, and is estimated to be 13,700 persons in 2007/08.

Adelaide's continual affordability advantage over most capital cities also supported the greater demand over the last two years to 2007/08, with purchasers less affected by the interest rate rises during that period. The number of loans to first home buyers and owner occupiers increased by 7% and 8% respectively from June 2006 to December 2007, before loan activity eased in the six months to June 2008, due to the 0.9% rise in housing variable rates in that period.

However, investors have remained in the market over the six months to June 2008, with total investor finance increasing by 38% between 2005/06 and 2007/08. The Adelaide rental market is particularly tight, indicating that investment supply is not meeting demand. Adelaide's residential rental vacancy rate since 2003 has improved dramatically to remain well below the balanced market level of 3%, to a low of 0.5% in December quarter 2006. More recently, the vacancy rate has risen to 1.5% as at June 2008—still traditionally tight by historical standards. As a result, rental growth has also been solid, remaining



considerably above the level of inflation. Rentals for three-bedroom houses expanded by 4.2% in 2006/07, and then by a further 6% in 2007/08.

6.2 FORECAST

Relatively attractive house affordability (although deteriorating slightly) and stronger population growth—stemming from overseas migration—in the future is expected to underpin house price growth, while softer wages growth and lesser employment opportunities will maintain younger age cohort movement out of South Australia. In this environment, we expect price growth to slow, but remain positive in 2008/09.

The rental vacancy rate in South Australia continues to tighten. This has fuelled strong rental growth, and given that the shortage in the rental market is expected to persist in Adelaide, we expect that this will contribute to moderate house price growth over the forecast period, as investor activity continues to increase.

Having averaged an estimated solid 12,200 persons over the three years to 2007/08, we are forecasting net overseas migration inflows to improve to an average of 13,800 persons per annum over the forecast period. This further influx in overseas migration is expected to result in added rental and owner-occupier demand for housing—particularly in the Adelaide market.

Against these positives, higher funding costs will have an impact on the market. Despite a 0.25% fall in the cash rate in September 2008, independent increases by lenders due to the deterioration in the wholesale debt market has provided further strain on the relative affordability in Adelaide. Combined with recent weak wages growth, it is



“This further influx in overseas migration is expected to result in added rental and owner-occupier demand for housing—particularly in the Adelaide market”

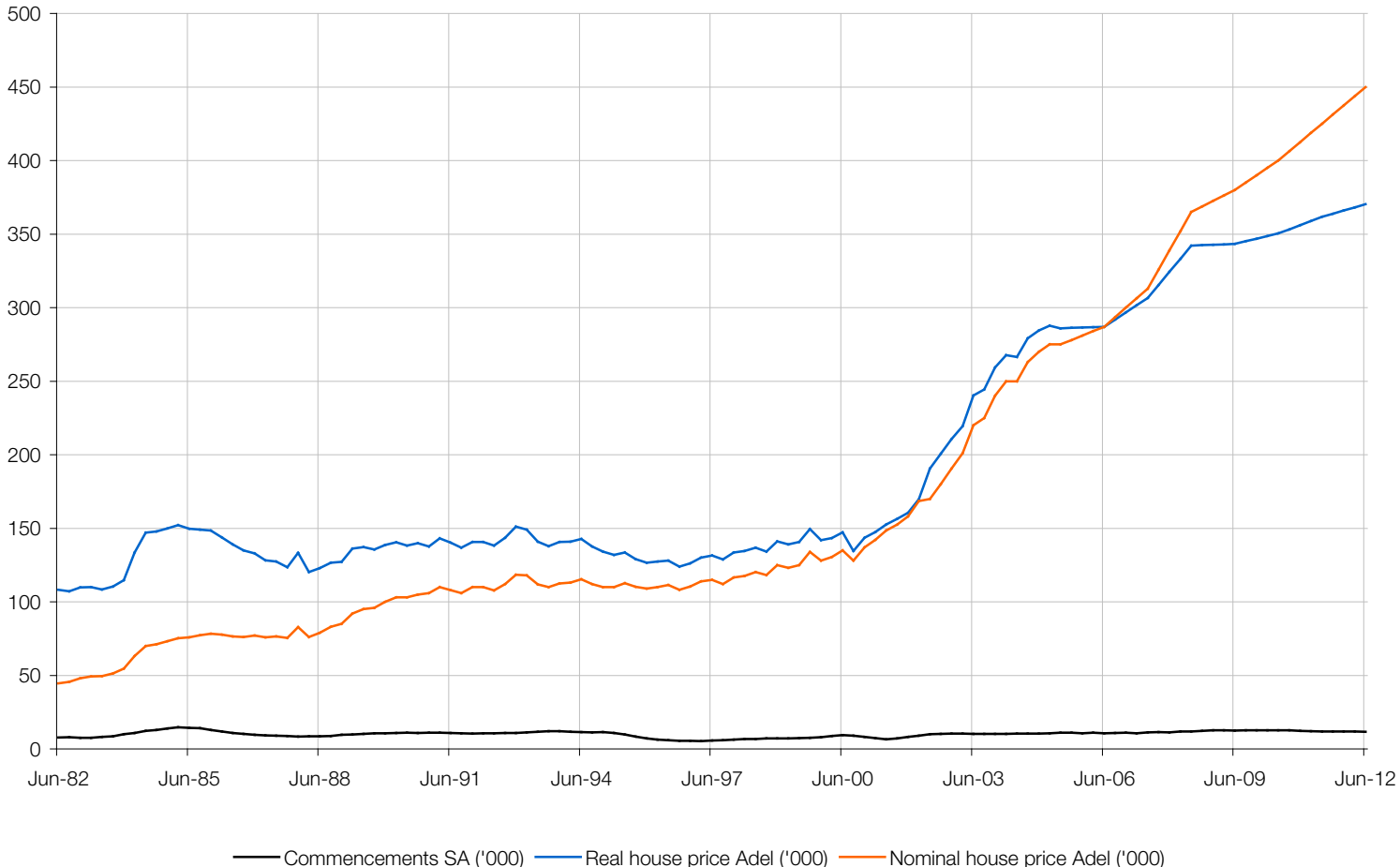
forecast that median house prices will increase by 4.1% in 2008/09, to \$380,000. This rate of growth, however, is better than expectations for all other capital cities.

With another 0.25% fall in the cash rate forecast in the first half of 2009 and the anticipated lowering of

housing variable rates by financial institutions over the course of 2009/10 as credit market sentiment and liquidity improves, residential property demand in Adelaide is expected to improve. In addition, the limited house price growth in 2008/09 coupled with an increase in wages growth will result in better

affordability. This is likely to provide added stimulus to the Adelaide property market, subsequently leading to forecast median house price growth of 5.3% in 2009/10 (to \$400,000) and 6.3% in 2010/11 (to \$425,000)—representing a return to real price growth of 2.1% and 3.2% respectively.

Chart 5: Adelaide Dwellings - Prices and Activity



Source: Australian Bureau of Statistics, BIS Shrapnel and Real Estate Institute of Australia date.

7.1 STATE OF PLAY

Over the six years to 2006/07, Western Australia's residential property market experienced substantial house price growth, with Perth's median house value increasing by a total of 173% or 18% per annum during those six years. The booming mining and resource sectors created solid employment and wages growth, enticing more people to the state. With the rate of population growth improving it supported an upturn in residential construction and activity.

Moderate price growth came through in 2001/02 and 2002/03, as net overseas migration into Western Australia improved and a stock deficiency emerged. This drove a 27% increase in Perth's median house price, from \$165,700 to \$210,200, between June 2001 and June 2003.

Despite this growth, Perth was the most affordable in relation to all other capital cities. Combined with an acceleration in the economy and a reversal of net interstate migration from an outflow to an inflow, this set the scene for a significant upturn in prices, underpinning a further 40% increase in Perth's median house price from June 2003 to June 2005.

By this stage, booming sentiment was also influencing prices, and in 2005/06, house price growth accelerated by a substantial 35.6%, raising the median house value to \$400,000. Population growth played a significant part in this increase, with the net inflow from overseas migration and interstate migration both improving significantly during the year to 22,400 persons and 4,000 persons respectively. Perth's tight residential rental market also fuelled this price growth. The vacancy rate fell to below 2% in 2005/06, which brought on rental growth of 23% for 3 bedroom houses and a 55% increase in the value of investor loans for the year.

Residential market conditions in Perth remained strong and peaked during the following six months to December 2006, which enabled the median value to achieve 13% growth for 2006/07. However, with affordability levels deteriorating quickly to be on par with Melbourne after the price growth in 2005/06, downward trends in Perth's residential market emerged over the six months to June 2007. Loan activity declined significantly, with the number of loans to first home buyers and owner occupiers falling by 13% and 10% respectively between January 2007 and June 2007, while investor finance also eased.

Upward pressure on house prices in Perth were also relieved in 2006/07 as the stock deficiency eroded,



and the residential market moved to a balanced position by June 2007. This position has remained in June 2008, with completions relatively matching demand. Demand from owner occupiers and investors remained weak in 2007/08, although first home buyer demand rose. However, this was largely due to the first home buyer incentives introduced by the State Government in May 2007. Overall, with affordability constrained, Perth's median house price fell by 1% in 2007/08 to \$446,000.

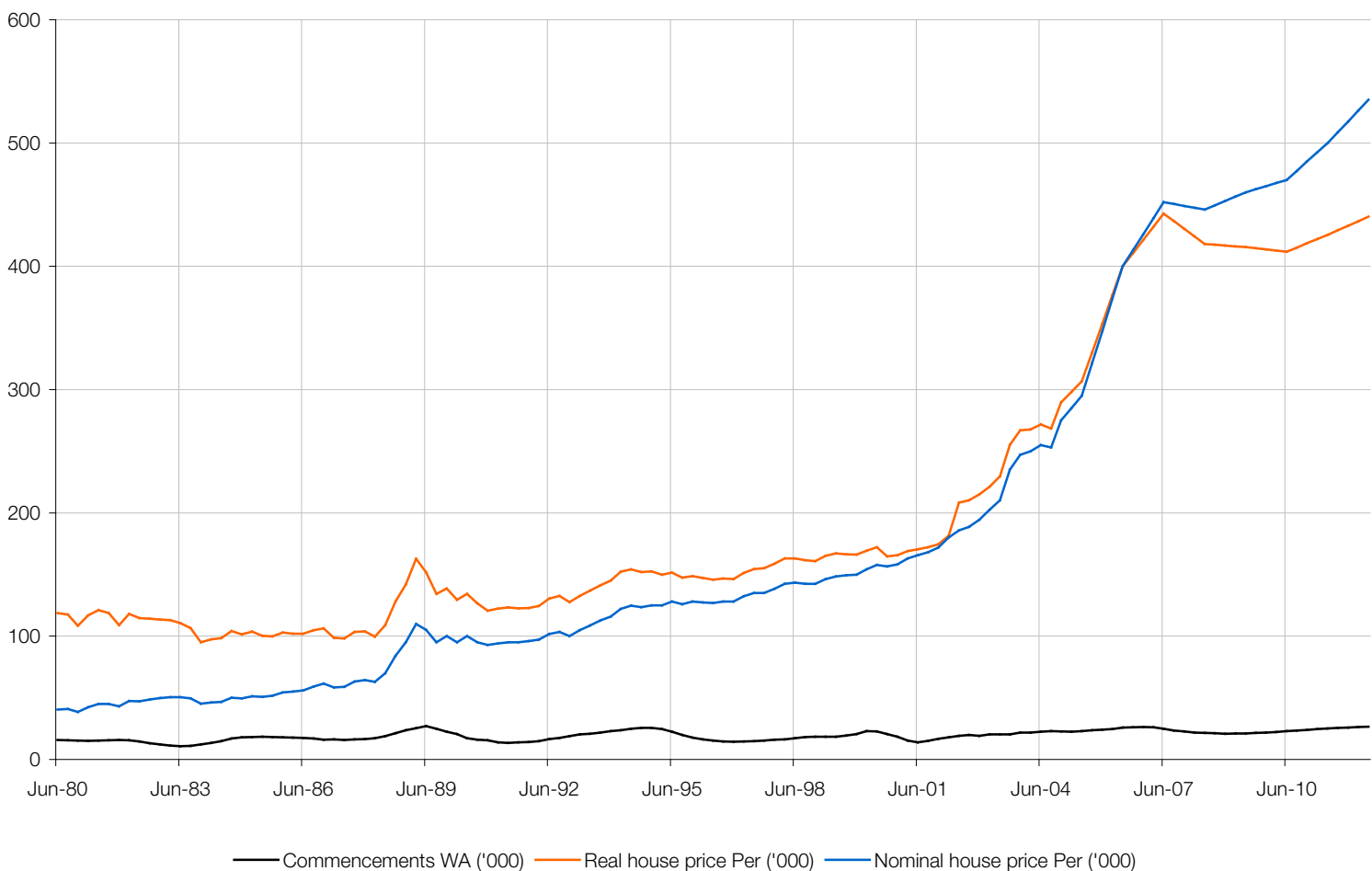
7.2 FORECAST

Population growth remains a key positive for the market. Net overseas migration to Western Australia has expanded considerably over the last two years to 2007/08 (in light of the resources boom). The recent trend of strong net overseas migration is expected to continue over the forecast period, anticipated to average 28,700 persons per annum over the four years to 2010/11. Interstate migration—although forecast to weaken to just 1,000 persons in 2009/10 and 2010/11—will add an average of 2,500 persons over the corresponding period.



“underlying demand is expected to increase substantially in Western Australia over the forecast period, increasing to an average of 25,000 new dwellings per annum—a 28% increment on the 2001-2006 average level”

Chart 6: Perth Dwellings - Prices and Activity



Source: Australian Bureau of Statistics, BIS Shrapnel and Real Estate Institute of Australia.

Subsequently, underlying demand is expected to increase substantially in Western Australia over the forecast period, increasing to an average of 25,000 new dwellings per annum—a 28% increment on the 2001-2006 average level. Also, with dwelling commencements in Western Australia forecast to decrease through 2008/09, it is expected that a sizeable stock deficiency will materialise in Western Australia over the forecast period, peaking at 8,500 dwellings by June 2011.

Despite these upward pressures on house prices in Perth, substantial

price growth between 2002 and 2007 and the rises in the housing variable rate over 2007/08 have deteriorated affordability, leaving little scope for further solid price growth in the short term. As a result a cautious view has been taken on the outlook for price growth over the next two years to June 2010. Perth's median house price is expected to increase by 3.1% in 2008/09 and 2.2% in 2009/10.

Although the level of overseas and interstate migration in Western Australia is expected to slow late in the forecast period, population

increases are likely to remain high by historical standards. As mentioned earlier, this will result in stronger underlying demand and an increasing stock deficiency in Western Australia. Given this deficiency, the current tightness of the rental stock in the Perth market, and falling housing variable rates over 2008/09 and 2009/10, price growth in Perth is expected to rise in 2010/11. Perth's median house price is forecast to increase by 6.4% in 2010/11, to \$500,000.

8. Hobart

8.1 STATE OF PLAY

Over the three years to 2003/04, the median house price in Hobart accelerated, rising by a cumulative total of 109%, from \$120,300 at June 2002 to \$252,000 at June 2004.

This substantial growth was driven by an increased underlying demand for dwellings. Between June 2001 and June 2004, underlying demand outpaced total completions by 2,200 dwellings, absorbing most of Tasmania's stock excess and leaving a stock surplus of just 500 dwellings at June 2004.

Stronger underlying demand was being underpinned by net interstate migration. In 2001/02, the net outflow from interstate migration fell to its lowest level since 1992/93, before reverting to an inflow in 2002/03—the first inflow in more than decade. The net inflow from interstate migration was 2,000 persons during the year, followed by another inflow of 2,600 persons in 2003/04.

Interstate migration inflow has a higher concentration in the 50+ age group. This group is likely to be trading down from an existing dwelling and less likely to be seeking full-time employment. Consequently, this age group is less affected by the more limited employment drivers in the state.

However, the growth in net interstate migration into Tasmania slowed as the relative housing affordability that Tasmania once provided declined to levels not seen since the late 1980s. Consequently, the inflow from interstate migration lowered to just 300 persons in 2004/05, leading to a slight softening in underlying demand, which in turn caused a marginal increase in the stock excess. This resulted in price growth slowing to 3.2% in 2004/05, taking the median value to \$260,000.

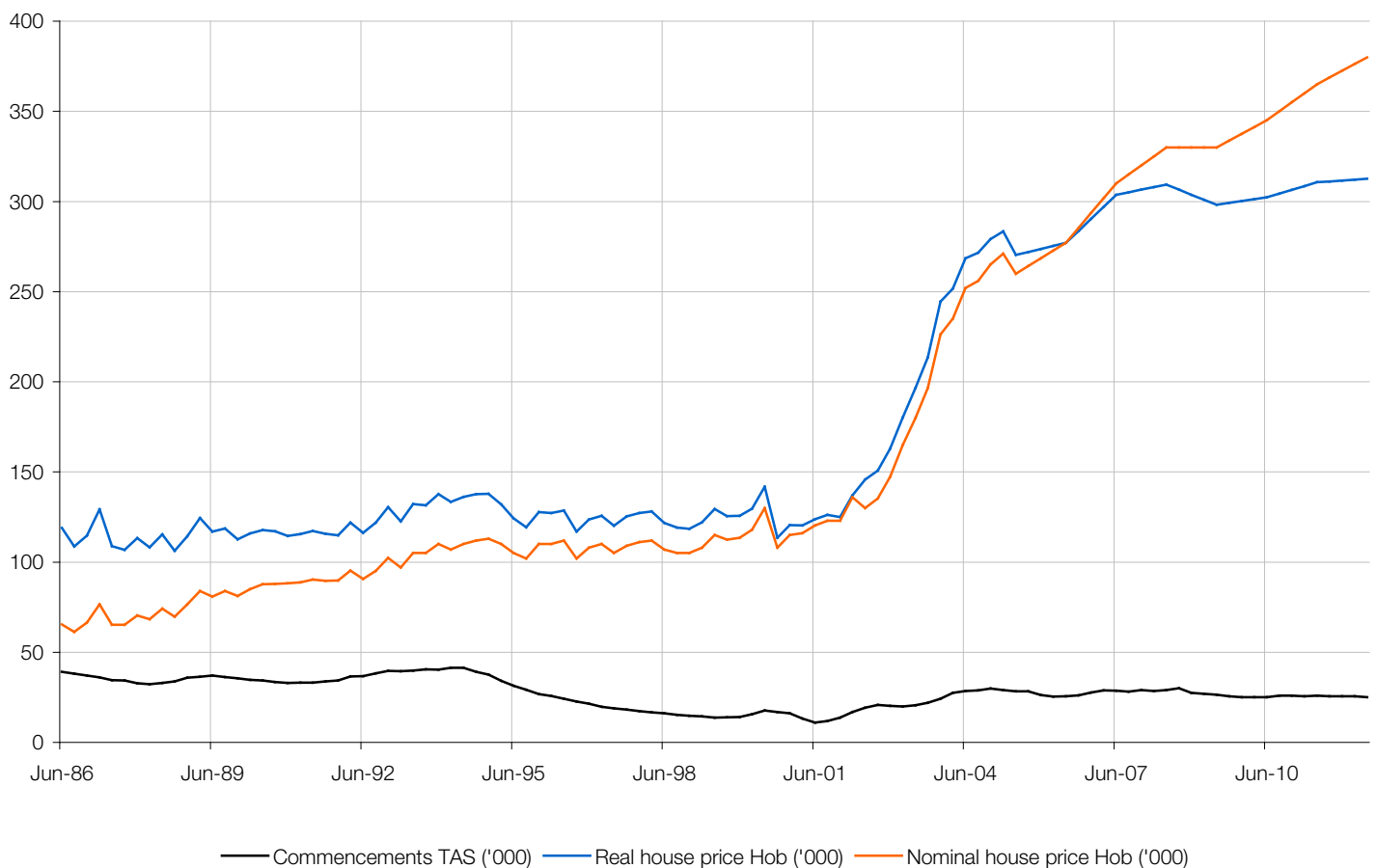
House price growth returned to solid levels over the three years to 2007/08, with Hobart's median house price increasing by an average of 8.3% per annum during that period, to reach \$330,000 by June 2008. This price growth, combined with the substantial rise in interest rates over the three years to 2007/08 has continued to erode much of Hobart's affordability advantage. Subsequently, despite Hobart still being the most affordable capital city in this period, interstate migration regressed back to a marginal net outflow.

As a result of the net interstate migration outflow over the three years to 2007/08, underlying demand has eased in Tasmania, causing the stock excess level to rise to 1,500 dwellings at June 2008. This weakening



“as interest rates decline over 2008/09 and 2009/10, purchaser sentiment should improve, with the median house price in Hobart forecast to rise to \$345,000, an increase of 4.5%”

Chart 7: Hobart Dwellings - Prices and Activity



Source: Australian Bureau of Statistics, BIS Shrapnel and Real Estate Institute of Australia.

in demand from the interstate migration outflow has occurred despite a positive influx of overseas migrants in Tasmania, averaging 1,300 persons per annum over the three years to 2007/08.

8.2 FORECAST

Hobart's relative affordability, in comparison to the other capital cities around Australia, is likely to be the most important determinate of price growth in the forecast period. This was the key driver of interstate migration, as house prices over 2002/03 and 2003/04 surged. Net interstate migration is projected to average an outflow of 1,000 persons per annum in the three years to 2010/11. Although this outflow from interstate migration should be counterbalanced by historically high

inflows from overseas migration, projected to average 1,400 persons per annum over the forecast period, annual average underlying demand is anticipated to ease to 2,200 dwellings between 2008/09 and 2010/11. With current total dwelling construction activity, already well above underlying demand, the stock surplus of 1,500 dwellings at June 2008 is estimated to rise to about 2,700 dwellings in June 2011, as construction activity in Tasmania continues to outpace demand.

Although Hobart is expected to be the most affordable state capital over the forecast period, accumulated median house price growth from June 2002 to June 2008 has eroded much of Hobart's affordability advantage.

As a result of the deterioration in affordability, weakening demand, and rising stock surplus, price growth in

Hobart is forecast to stall, with the median house price remaining flat at \$330,000 by June 2009.

However, as interest rates decline over 2008/09 and 2009/10, purchaser sentiment should improve, with the median house price in Hobart forecast to rise to \$345,000, an increase of 4.5%. This is forecast to continue over 2009/10, as the median house price in Hobart rises by a further 5.8% to \$365,000.



9. Darwin



9.1 STATE OF PLAY

Between 2003/04 and 2006/07, median house prices in Darwin rose by 92% or an average of 18% per annum. This rise in the median house price was underpinned by a surge in annual underlying demand over that period, which eroded the stock excess from 1,100 dwellings at June 2004 to an estimated stock excess of just 100 dwellings at June 2007.

Demand to Darwin has been boosted by the increase in net overseas migration, which averaged 1,200 persons per annum from 2003/04 to 2006/07, and the slowing of the interstate migration outflow, after Darwin recorded high interstate outflows from 2000/01 to 2003/04.

The strength in demand for residential dwellings in Darwin has been facilitated by the mining and infrastructure investment boom, which has resulted in a deficiency of dwelling stock emerging in Darwin over 2007/08 from a surplus over 2006/07. This turnaround has been reflected in the tightening of vacancy rates over the past few years to below a balanced market rate of 3%. The trend toward relatively lower vacancy rates has been translated to significant rises in rents over 2006/07 (8% annual increase) and 2007/08 (8.7% annual increase).

Despite the 1.4 per cent rise in interest rates over 2007/08, the continued booming economic conditions are supporting employment, wage, and population growth. Consequently, house price growth remains robust, increasing by 8% to \$425,000 in 2007/08.

9.2 FORECAST

The current phase of investment in the mining and infrastructure sectors is forecast to peak in 2008/09. This downturn in investment however will have little impact on house price growth over the three years to 2010/11, with a more pronounced effect expected beyond the forecast period.

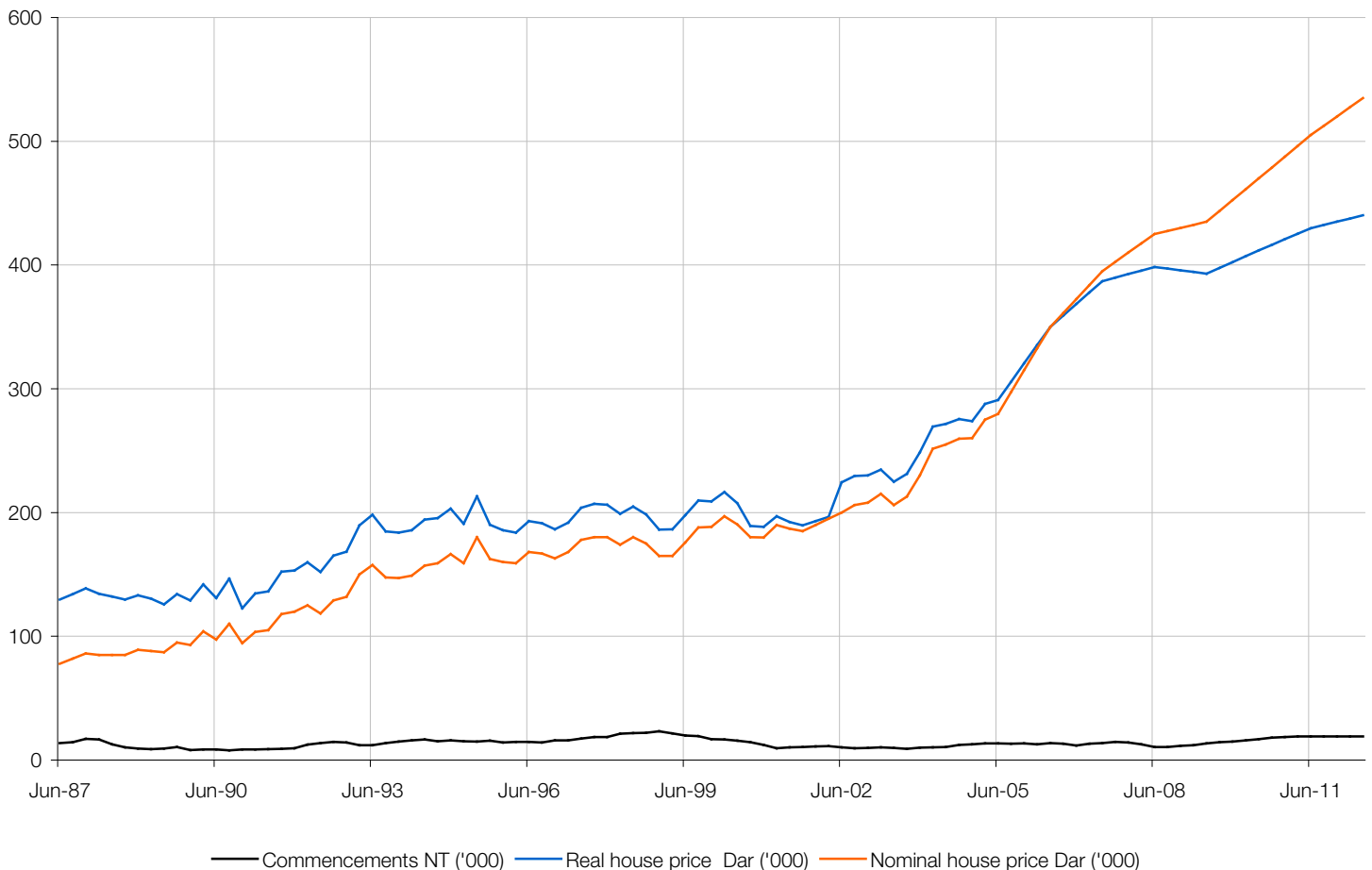
Similar to Hobart, affordability in Darwin is expected to be a key determinant of price growth going forward. The substantial rises in interest rates over 2007/08 are anticipated to slow house price growth in Darwin over 2008/09 to just 2% as the deterioration of affordability impacts on purchaser sentiment.

However, in addition to the September 2008 cash rate decline, the Reserve Bank of Australia is expected to drop the cash rate again in 2008/09 (0.5% total decline over 2008/09) in response to weakening economic conditions and sliding consumer and business confidence. Darwin's median house price is forecast to increase by 8% in 2009/10 to \$470,000.

Over 2010/11, although underlying demand into the Northern Territory is expected to slow, the decline in housing variable rates over 2008/09 and 2009/10 is expected to provide sufficient impetus for further rises in house prices. Consequently, the median house price in Darwin is forecast to increase by 7.4% in 2010/11, to \$505,000.



Chart 8: Darwin Dwellings - Prices and Activity



Source: Australian Bureau of Statistics, BIS Shrapnel and Real Estate Institute of Australia.

10. Canberra



10.1 STATE OF PLAY

The median house price in the Australian Capital Territory experienced significant growth in the five years to 2003/04, increasing at a rate of 18% per annum, from \$158,000 to \$372,400. Consequently, affordability deteriorated, whereby the average monthly mortgage payment on a median priced house as a share of average monthly income rose from a low of 21% in 1999/2000 to 42% in 2003/04.

With affordability deteriorating, the net interstate migration outflow began increasing in 2001/02 and remained high through to 2004/05, peaking a year earlier at 2,400 persons in 2003/04.

Canberra's median price receded in 2004/05, falling by 5% during the year to \$352,500. This coincided with weak employment growth in the Australian Capital Territory, as well as slowing rental increases. Price growth then rebounded in 2005/06, rising by 8% to \$380,000 in June 2006. This was driven by a turnaround in interstate migration into the Australian Capital Territory, which underpinned a rebound in house prices and rentals.

The rise in the Australian Capital Territory's net interstate migration intake during 2006/07 strengthened underlying demand, contributing to the development of a moderate stock deficiency. Consequently, the median house price in Canberra rose by 12% and rental growth accelerated to 9.4%.

By 2007/08 however, affordability in Canberra had deteriorated considerably. Interest rates had risen by 1.4% in 2007/08, in addition to rising house prices over 2005/06 and 2007/08. As a result, Canberra's median house price slowed to just 3% in 2007/08 to \$440,000.

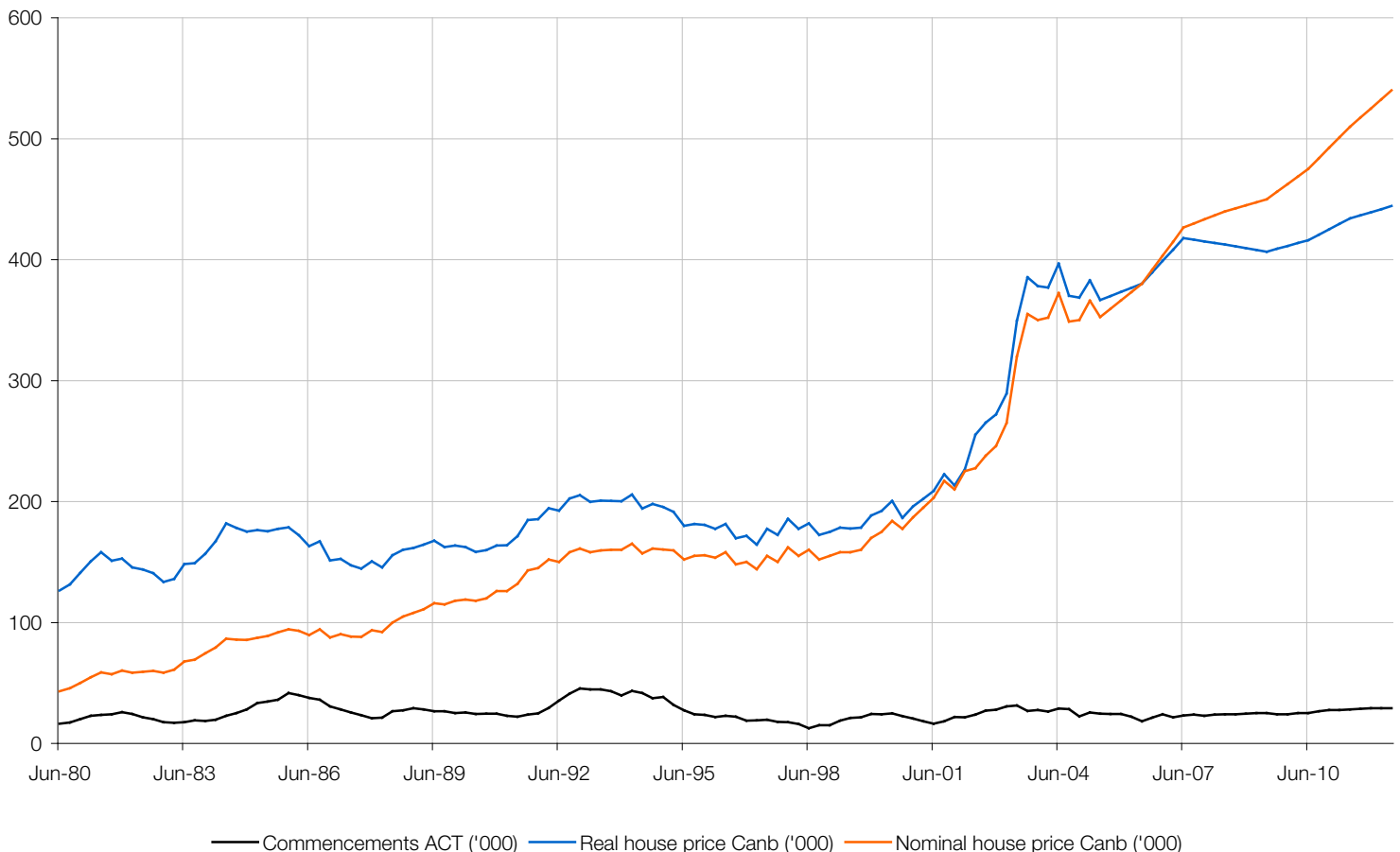
10.2 FORECAST

Canberra's interstate migration is expected to revert back to balance in 2008/09, partially reflecting slowing jobs growth after cutbacks in public sector employment by the Federal Government. This is anticipated to lead to reduced underlying demand for housing. The median house price in Canberra is forecast to rise by just 2% in 2008/09 to \$450,000. The reduction in underlying demand is expected to carry through to rents, with median rental growth forecast to slow to 5.3%.

Over the two years to 2010/11, the decline in interest rates by both the Reserve Bank of Australia and the banks independently during 2008/09 and 2009/10

“house prices are forecast to rise by 5% in 2009/10 and 7% in 2010/11, increasing the median house price to \$510,000 by June 2011”

Chart 9: Canberra Dwellings - Prices and Activity



Source: Australian Bureau of Statistics, BIS Shrapnel and Real Estate Institute of Australia.

DISCLAIMER

The information contained in this publication is provided for information purposes only and is not intended to constitute legal, financial or other professional advice and has not been provided with regard to the investment objectives or circumstances of any particular reader. While based on information believed to be reliable, no guarantee is given that it is accurate or complete and no warranties are made by QBE Lenders' Mortgage Insurance ("QBE LMI") as to the accuracy, completeness or usefulness of any of the information in this publication. The opinions, forecasts, assumptions, estimates, derived valuations and target price(s) (if any) contained in this material are as of the date indicated and are subject to change at any time without prior notice. The information referred to may not be suitable for the specific investment objectives, financial situation or individual needs of recipients and should not be relied upon in substitution for the exercise of independent judgement. Recipients should obtain their own appropriate professional advice. Neither QBE LMI nor other persons shall be liable for any direct, indirect, special, incidental, consequential, punitive or exemplary damages, including lost profits arising in any way from the information contained in this material. QBE LMI owns copyright in this material. This material may not be reproduced, redistributed, or copied in whole or in part for any purpose without QBE LMI's prior authorised written consent.

