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Property Outlook

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Economic Overview

The recent performance of the economy is proving somewhat confusing for the markets and policy makers. Everyone knew that the end of the house price boom would lead to a cooling in domestic demand. But what is disappointing is that the much vaunted commodity price boom is not yet creating sufficient activity to fully take up the slack *(Tony Pearson): page 2*

Residential Property

A further modest tightening in interest rates in mid-2006 is likely to be the only domestic 'cloud' for the housing market and will be effective in keeping values subdued over much of 2006-07. With very high and rising pent-up demand, tightening vacancies and improving rentals all brewing over a period of solid incomes growth, the scene is set for a notable 'kick' in price growth over 2007 - one which is unlikely to be sustained for too long but will nonetheless serve as a trigger to restore balance to a market in desperate need of more dwellings.

New South Wales has continued to bear the brunt of the cyclical downturn in housing with falls in house prices, sales turnover and new dwelling approvals far in excess of that experienced in other states. The Victorian housing market has fared significantly better than NSW, and on most broad criteria has enjoyed a relatively soft landing. *(Paul Braddick & Ange Montalti): page 3*

Commercial Property

There has been a notable tightening in CBD office market conditions in the past few quarters. However, with jobs growth set to slow sharply, net absorption for office space will fall significantly over 2006, offering a timely reality check for a market threatening to undergo a 'mini- boom'.

Industrial property markets have strengthened in the past 6 months, with total returns rising to 14.5% over the year to June. Growth is being driven by a scarcity of warehouse space and growing demand for retail distribution facilities. Continued solid institutional demand for industrial property has seen yields tighten further in both prime and secondary markets.

Suburban shopping centres will continue to be supported by rapid growth in residential development in the outer fringe. But new floorspace following the completion of expansion projects in existing centres and new neighbourhood centres will limit rental growth.

The accommodation sector has benefited from strong international tourist arrivals. The outlook for overseas visitor arrivals looks promising with the Tourism Forecasting Committee predicting growth of around 5.6% per year over 2006-07. The main risks, however, include heightened security concerns and the outbreak of a virus in the region (as in the case of SARS and current concerns of a widespread incidence of bird flu), which would severely reduce overseas visitor numbers.
(*Jasmine Robinson, Ange Montalti & Paul Braddick*): page 8

Economic Overview

The Australian economy grew by just 0.2% in the September quarter. The annual rate of growth came in at 2.6%, the fourth consecutive quarter of annual growth below 3%.

The recent performance of the economy is proving somewhat confusing for the markets and policy makers. Everyone knew that the end of the house price boom would lead to a cooling in domestic demand. But what is disappointing is that the much vaunted commodity price boom is not yet creating sufficient activity to fully take up the slack.

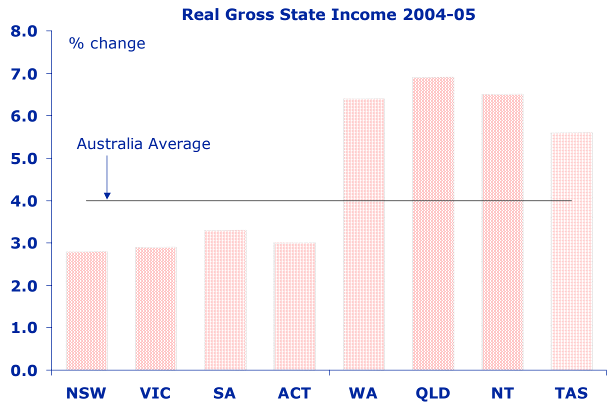
The slowing in economic activity has translated into weaker employment growth, as we would expect. In fact employment growth has stalled - there has been no increase in employment for 3 months. The trend rate of unemployment has been stable at 5.1% for a year. The labour market remains tight, but is not tightening further. In response, wages have stopped accelerating, although growth remains high. The Labour Price Index rose by 1% in the September quarter, below the 1.1% in the two previous periods.

2006 looks like being a more solid year of growth. We are estimating an increase of 3½% in GDP. This will reflect:

- Moderate household consumption, which will continue to be hampered by high fuel prices, higher interest rates and the ending of the house price boom.
- A rebound in dwelling investment, in response to strong underlying demographics and a tightening rental market.
- Sustained strong business investment as companies continue to expand export capacity and infrastructure.
- A stronger export performance as commodity infrastructure comes on line, and as rural exports increase in response to the breaking of the drought.

One of the features of the current growth story is that economic activity differs sharply between the states. Generally, the states with the largest exposure to the mining industry are performing the best. This includes the NT and WA. In contrast, those states, which are less able to leverage off the commodity boom, are performing less well, in particular NSW and Victoria. The exception to the rule is Tasmania, which continues to record strong rates of growth despite a low exposure to mining.

Australia is a country of two halves

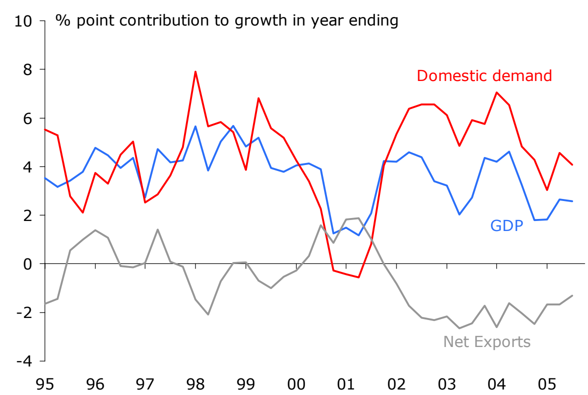


Sources: Australian Bureau of Statistics.

Inflationary pressures have swelled through 2005 with headline inflation running at an annual rate of 3% in the September quarter, right at the top of the RBA's 2% to 3% target band. The RBA has moved to a soft tightening bias, and has warned of upside risks to inflation. In particular they would be concerned about further rises in fuel prices, if there was pass through of higher input costs to consumer prices, and if wages growth accelerated. To this we would add the risk of a further decline in the $A.

We have had a long standing view that interest rates will need to rise again, but we do not expect this until at least the middle of 2006, when the recovery in dwelling investment, employment growth, and household spending, will create clearer signs of upward risks to the inflation target. An increase of 25bp would lift the cash rate to 5.75%, but that would still be below the previous peaks of 6.25% in late 2000, and 7.50% in 1995-96.

GDP growth remains below trend



Source: ABS

ANZ

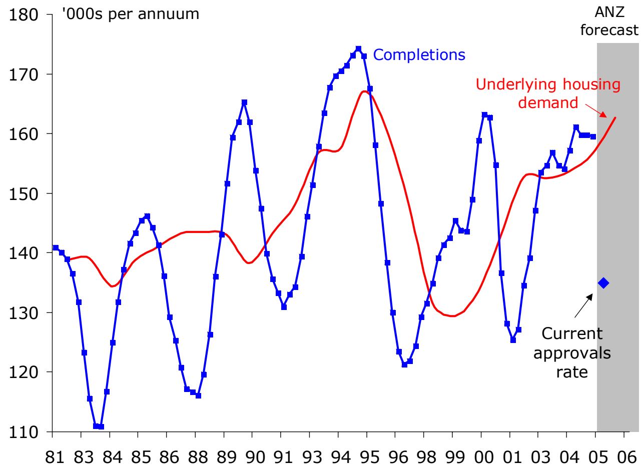
Residential Property

Sowing the seeds of the next upturn

Though less so in recent years (due to relatively stable interest rates and economic activity), the Australian housing market has always been *highly cyclical*. The housing construction market generally swings from over-development to under-development and it is this second phase of the cycle that we are currently in.

In the past quarter of a century, annual new dwelling starts averaged 173,000 at the peak of each cycle and fell to an average of 116,000 dwellings at the nadir of each housing downturn[1]. In contrast, underlying demand has been relatively stable as evidenced in the chart below.

Approvals are *well* below underlying demand



In the current 'cycle', new building approvals have already fallen to levels that are well below underlying requirements and consequently, are now setting the scene for the next upturn.

Our estimates of underlying demand have been upwardly revised in response to new population projections released by the Australian Bureau of Statistics[2]. This revision along with other minor adjustments to demolition rates, have boosted underlying demand from a previously estimated 160,000 p.a. to the current estimate of 165,000 p.a. We are basing this projection on net overseas migration assumption of 130,000 for 2005-06 and 2006-07. While migration has been at higher levels on occasions in the past, the mix of migrants and demographics (lower average household size), imply a translation to housing demand that is challenging the record highs measured in the mid-1990s. Despite this, weakened developer sentiment has caused new dwelling approvals to fall to an annualised starts/completions rate of just 135,000 in the 3 months to October.

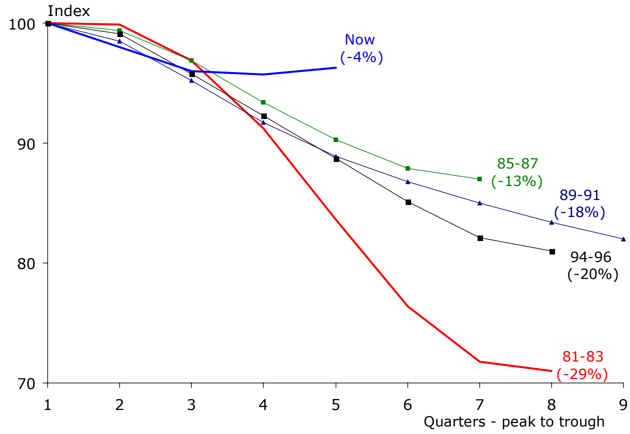
The marked tightening in the overall housing demand/supply balance is already reflected in rental markets where vacancy rates are falling sharply in most capital cities. Moreover, new building rates in the year ahead will be insufficient to match demand, creating the conditions that will drive the next upturn. Markets will tighten even further, placing upward pressure on rents, rental yields and eventually prices.

Building downturn will be mild

Despite much negative speculation, the housing market has clearly achieved a soft landing and the current downturn in dwelling investment will be both shallow and short-lived when compared to earlier experience. On top of strong underlying demand and a solid economic outlook there is still an enormous backlog of work yet to be done that will continue to support building activity in the year ahead.

This downturn *will* be different

Real dwelling investment



Are we seeing a long-term shift in tenure?

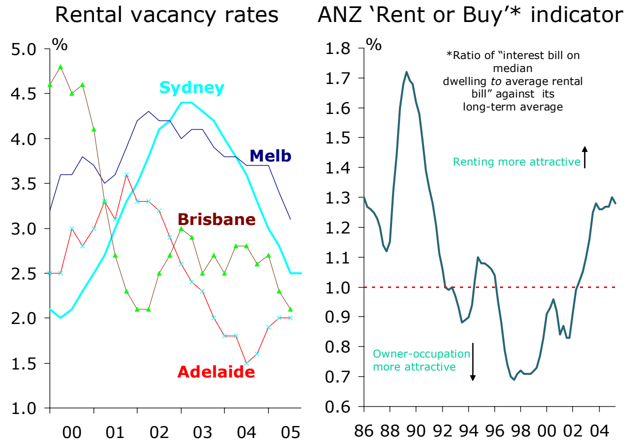
The run-up in prices in recent years has had a marked impact on affordability, particularly among those with no pre-existing equity in housing (first home-buyers). Rentals, on the other hand have been relatively sluggish. Together, these

[1] Excluding the GST induced downturn in 2000

[2] Series B has been selected as the most plausible option although we have super-imposed an alternative set of migration assumptions incorporating higher business migrant quotas announced in 2005.

developments have taken the ANZ's 'rent or buy' indicator[3] to around its highest level in 14 years.

Rental markets continue to tighten



Source: REIA, ABS, RBA, Economics@ANZ

Note: indicator takes no account of non-financial criteria in tenure decisions

Historically, interest rates played a critical swinging role in unleashing pent-up demand or restricting demand to below 'desired' levels but implicitly also diverted demand for housing across tenure types[4]. It is plausible that some of the tightness in rental markets is reflecting this diversion as well as a general shortage in dwelling stock.

In today's more stable interest rate environment, shifting relative cost is likely to be more gradual than history shows. The battlelines are being drawn between the great Australian dream of owning a home and the relative financial attraction of becoming a tenant. It is possible the forthcoming strength in rentals (in response to dwelling shortages) will restore, at least partially, the incentive towards a more neutral position. In the meantime, rental markets should receive good support.

House prices will 'kick' in 2007

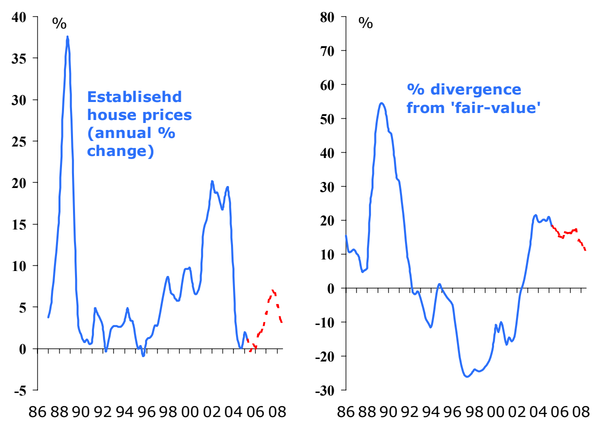
House prices have, by and large, on the various available measures, moved sideways since early 2004. We have consistently argued since 2002 that despite the 'boom' in house prices over the past half-decade or so, a major systemic correction was (and remains) unlikely.

History shows that even in recession where interest rates are high and unemployment is rising, the worst house prices can do (even following a period of strong prices growth) is to show little or no growth.

The current economic environment offers a stark contrast to the conditions that could trigger a 'correction'. Interest rates are low and stable, labour markets are firm and household income growth is solid. This macro-environment is expected to persist over the medium-term and will be providing a very strong foundation for house prices going forward. But it is the housing market fundamentals themselves that will be providing the greatest insurance against price falls over at least the next two to three years.

A further modest tightening in interest rates in mid-2006 is likely to be the only domestic 'cloud' for the housing market and will be effective in keeping values subdued over much of 2006-07. With very high and rising pent-up demand, tightening vacancies and improving rentals all brewing over a period of solid incomes growth, the scene is set for a notable 'kick' in price growth over 2007 - one which is unlikely to be sustained for too long but will nonetheless serve as a trigger to restore balance to a market in desperate need for more dwellings.

House prices will accelerate in 2007



Source: ABS, RBA, Economics@ANZ

Despite our fair-value analysis suggesting prices are still 18% over-valued[5], we believe adjustment to this overvaluation will be gradual and is entirely consistent with moderate price rises over the medium and longer-terms.

Dwelling starts forecasts ('000): 03/04: 172, 04/05: 156, 05/06: 155, 06/07: 174

[3] Measures the ratio of the 'interest bill on a median home to the average rental bill' against its long-term average

[4] This typically manifests itself via a delay in household formation (kids staying home for longer) and in a greater % of new households choosing tenancy over ownership (at least as an interim arrangement.

[5] A restatement of ABS house price data has caused some revisions to our estimates of fair value.

State Trends

New South Wales

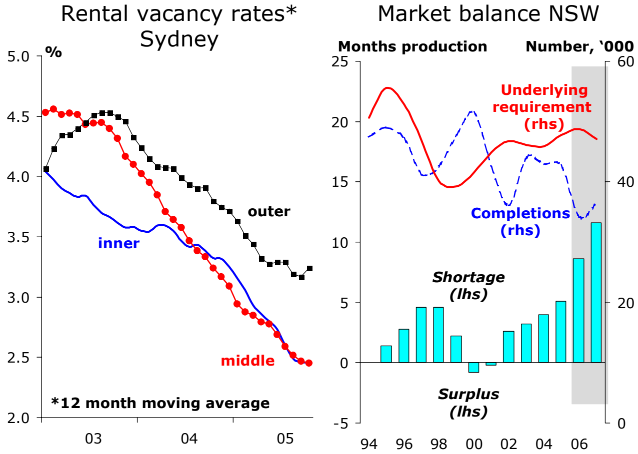
New South Wales has continued to bear the brunt of the cyclical downturn in housing with falls house prices, sales turnover and new dwelling approvals far in excess of that experienced in other states. From a peak in December 2003, Sydney house prices have fallen by 9.7% - over the same period weighted average house prices in other state capitals have actually *risen* by 7%! Similarly, from a peak in late 2003, new dwelling approvals in NSW have fallen by 43% while ex-NSW approvals are down by a more modest 20%.

Note, after almost halving since the peak in late 2003, the volume of home sales rebounded in the September quarter, although this could simply reflect a rush of 'pent up' sales following the removal of the vendor tax.

Much of the blame for the slump in housing can be levelled at the parlous economic performance of the NSW economy in recent years. NSW has considerably underperformed with growth in real GDP (+1.1% '04/'05), employment (+1.8% year to November) and population (+0.8% '04/'05) well below the outcomes in most other states. While data limitations make it impossible to be definitive, economic conditions in NSW in 2004 were close to recessionary and have remained extremely weak in 2005.

In addition, difficult housing affordability has added to the NSW population exodus, driving average annual net interstate migration losses to 29,000 people over the past 3 years.

But it's not all doom and gloom



Sources: ABS Cat. No. 8750.0, 3222.0, 3101.0, REINSW, Economics@ANZ

Paradoxically, housing market *fundamentals* have tightened in Sydney to a far greater extent than in other state capitals. Despite, an ongoing high net interstate migration loss, underlying housing demand is at high levels and remains above the rate of dwelling completions leading to a tightening in the aggregate market balance. This is reflected in sharp falls in rental vacancy rates, particularly in inner and middle Sydney areas.

Our market balance analysis predicts a significant further tightening in the year ahead. The recent collapse in new dwelling approvals suggests completions will fall to just 34,000 in 2005-06 while underlying housing demand will increase to 48,700 driving a sharp rise in our estimate of 'pent up' demand. This will force vacancy rates even lower, placing renewed upward pressure on rents and rental yields.

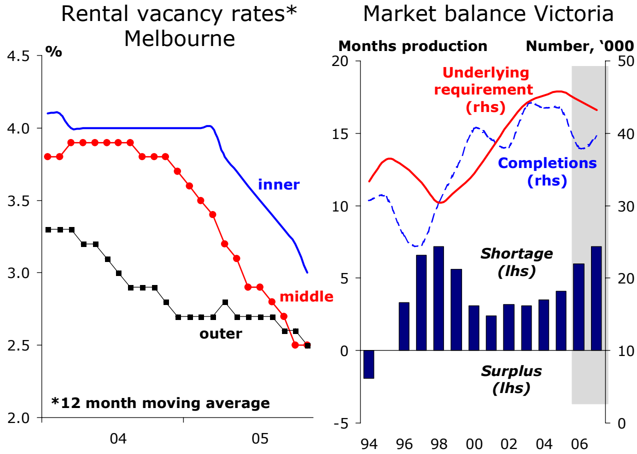
Despite the fall in Sydney house prices, our analysis suggests Sydney house prices are still overvalued by 12%, although this is down sharply from 28% in early 2004.

Dwelling starts forecasts ('000): 03/04: 44.1, 04/05: 37.0, 05/06: 35.5, 06/07: 41.2

Victoria

The Victorian housing market has fared significantly better than NSW, and on most broad criteria has enjoyed a relatively soft landing. After peaking in December 2003, Melbourne house price growth has stalled, but unlike Sydney, prices have not suffered significant falls. The fall in sales activity in Melbourne in 2004 was only around half that experienced in Sydney and more recently, sales activity and confidence have improved. Housing finance approvals have rebounded strongly in 2005 reflecting solid underlying fundamentals and an increasing recognition that neither a sharp rise in interest rates nor a collapse in house prices are likely.

Market fundamentals remain strong



Sources: ABS Cat. No. 8750.0, 3222.0, 3101.0, REINSW, Economics@ANZ

Like Sydney, the fundamentals of the Melbourne housing market remain solid. Underlying demand has exceeded completions for the past 2 years and subdued new dwelling approvals suggest the stock deficiency will widen considerably in the year ahead. Rental vacancy rates in Melbourne have continued to decline - even in the much maligned inner-city apartment market as new stock continues to be absorbed relatively quickly.

Despite relatively positive fundamentals, Melbourne house prices remain overvalued (by 17% in the September quarter).

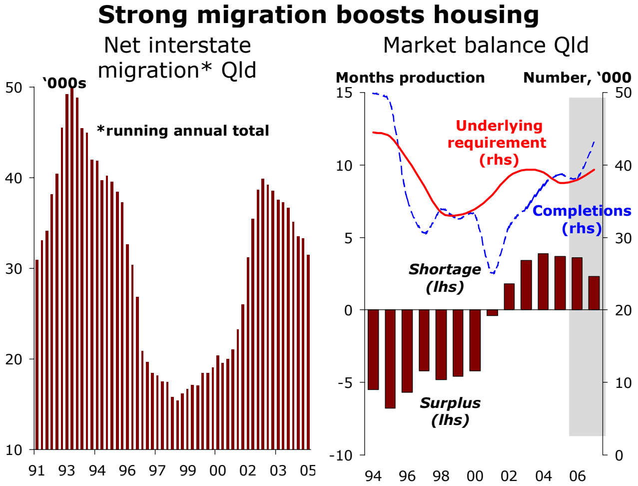
Dwelling starts forecasts ('000): 03/04: 45.3, 04/05: 40.6, 05/06: 38.2, 06/07: 43.9

Queensland

The Queensland housing market ran extremely hot in the 5 years to 2004. Brisbane house prices grew by 106% over this period (a performance matched only by Hobart) and new building activity rose sharply. Queensland continued to be the major beneficiary of the population exodus from NSW with net interstate migration into Queensland averaging 36,000 per annum in the past 3 years up from a low of just 15,400 in 1998.

However, the Queensland housing market has slowed in 2005. House prices have flattened and new dwelling approvals are 30% below their early 2004 peak. Sales activity in the established market slumped in 2004 but finance approvals suggest activity has recovered strongly in the past 3 months, particularly in the owner-occupied sector.

Strong migration boosts housing



Sources: ABS Cat. No. 8750.0, 3222.0, 3101.0, REINSW, Economics@ANZ

While our market balance suggests Queensland is in a relatively strong pent-up demand situation, our forecasts see this being steadily whittled away as new dwelling construction exceeds underlying demand in both 2006 and 2007.

Despite buoyant economic conditions, our analysis suggests Brisbane house prices were overvalued by 23% in the September quarter.

Dwelling starts forecasts ('000): 03/04: 43.6; 04/05: 38.3, 05/06: 40.9, 06/07: 46.4

South Australia

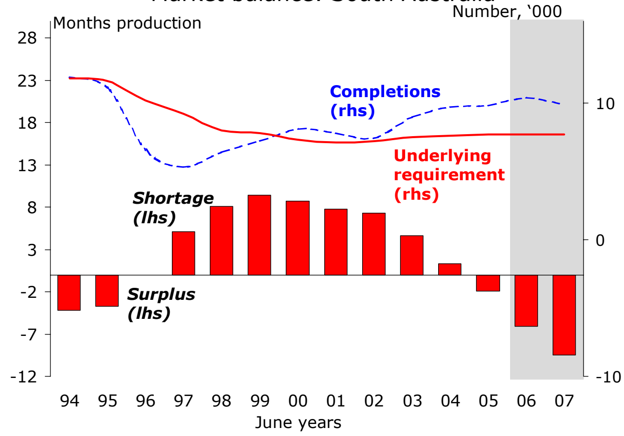
The South Australian housing sector has enjoyed very strong conditions in recent years. Adelaide house prices have doubled in the past 6 years and while slowing, have retained some positive momentum in 2005, with house prices expanding by 4.2% over the year to September.

The solid recovery experienced since 2000 can be directly attributed to the significant shortage of housing over this period flowing a slump in new building activity in the late 1990s. By mid-2004, this had driven rental vacancy rates to 20-year lows of just 1.5% making the Adelaide market the tightest of all the State capitals.

However, since mid-2001, South Australian dwelling starts have risen sharply to an 11-year high in June 2005. In contrast to the slump in new dwelling approvals in the eastern-seaboard capitals, new building approvals in South Australia have remained relatively strong.

Overbuilding has led to excess supply

Market balance: South Australia



Source: ABS Cat. No. 8750.0, 3222.0, 3101.0, Economics@ANZ

Robust new development activity has lifted house completions to levels well above underlying housing demand. Consequently, the market balance has shifted from a strong pent-up demand situation in the late 1990s and the early part of the current decade, to excess supply in 2005 and rental vacancy rates (while remaining relatively tight) have begun to rise. Current levels of building activity and approvals suggest that this excess supply will become substantially larger in the years ahead.

Confidence in the South Australian housing market remains high as evidenced by robust levels of housing finance approvals. However, a growing excess supply of dwellings suggests this optimism may be misplaced.

After, being undervalued as recently as early 2003, Adelaide house prices are now overvalued by 22%.

Dwelling starts forecasts ('000) 03/04: 10.0, 04/05: 10.5, 05/06: 10.4, 06/07: 10.0

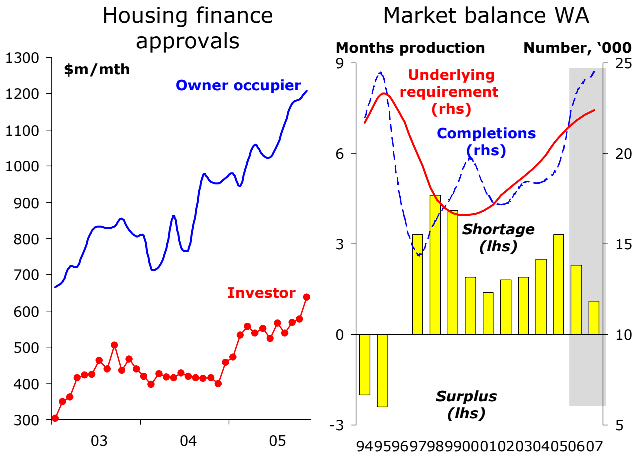
Western Australia

In contrast to the marked slowing experienced in most other state housing markets, the Western Australia housing sector remains in 'boom' conditions. Sharp rises in mining commodity prices in recent years have underpinned the current surge in incomes, employment and investment in the Western Australian economy. Ebullient economic conditions are mirrored in the housing sector, pushing sales, prices and new building activity sharply higher.

Perth house prices have continued to rise sharply and were up 17% over the year to September 2005. The buoyancy of the market is also being reflected in spectacular growth in housing finance approvals, particularly in the investor segment (in stark contrast to the relative weakness of investor lending in other states). Over the year to October total housing finance approvals are up 37%, led by an astonishing 60% rise in investor loans.

Rising underlying housing demand is being underpinned by strengthened population growth as buoyant economic conditions create increased employment opportunities. Relatively subdued dwelling construction in recent years has seen the Western Australia market balance tighten and rental vacancy rates have fallen.

WA housing is 'booming'



Sources: ABS Cat. No. 8750.0, 3222.0, 3101.0, REINSW, Economics@ANZ

However, while market fundamentals remain solid, the growth in lending, building activity and house prices experienced in recent years is clearly not sustainable. Despite continued growth in underlying housing demand, our estimates suggest building activity will exceed demand in coming years, forcing the market back towards 'balance'. Moreover, the recent surge has driven house prices to levels that are considerably overvalued (by 23% in the September quarter).

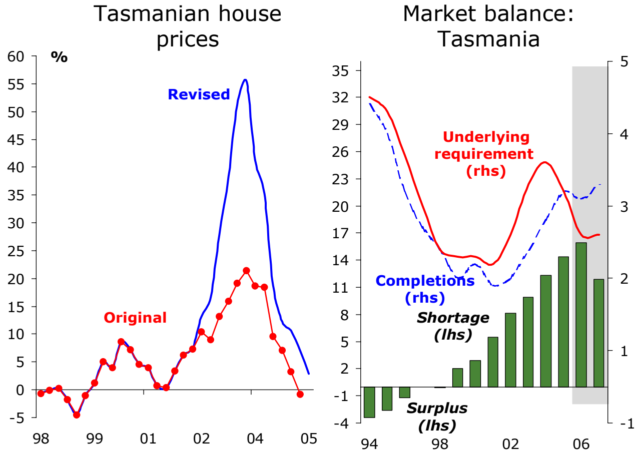
Dwelling starts forecasts ('000): 03/04: 22.5, 04/05: 23.2, 05/06: 24.6, 06/07:25.9

Tasmania

The Tasmanian housing sector and broader economy have come a long way from the 'dark days' in the 1990s when large net interstate migration losses saw the total population decline. A solid turnaround in economic activity has seen Tasmania attract a positive net migration flow since mid-2002 that has lifted underlying housing demand considerably above new building activity.

The strength of the market is reflected in the enormous upward revision to the ABS house price series for Hobart. Previous estimates suggested Hobart house prices had risen by just 37% between March 2002 and June 2005, while the revised measure puts the gain at a massive 105% over the same period.

Dwelling shortage has led a housing boom



Sources: ABS Cat. No. 8750.0, 3222.0, 3101.0, REINSW, Economics@ANZ

More recently, net interstate migration has slowed and underlying housing demand has weakened and new building is likely to exceed demand in the years ahead. Despite this, the market will remain in a solid 'pent-up' demand position for sometime suggesting a reasonably sanguine outlook for the Tasmanian housing market.

Dwelling starts forecasts ('000): 03/04: 2.8, 04/05: 2.8, 05/06: 2.7, 06/07: 3.0

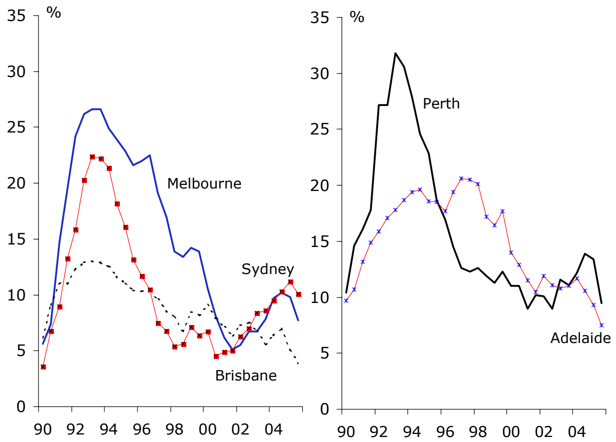
Commercial Property

CBD Office markets

There has been a notable tightening in CBD office market conditions in the past few quarters, reflected in vacancy rates (down from 9.5% to 7.6% in the year to July 2005).[6] The improved fundamentals are also beginning to reflect in valuations and yields. While part of this value adjustment reflects ongoing yield re-alignment towards a 'normal' premium above the risk-free benchmark, some of it reflects a shift in the fundamentals of office demand and supply.

The key driver of the tightening conditions can be traced to very strong employment growth, underpinned by business confidence and healthy profits. These conditions have lifted new net demand for office space nationally to near record levels (around half a million square metres over the past year). The impact on vacancies has been most significant in those centres that have had sluggish supply flows (e.g. Brisbane, Perth and Adelaide).

CBD Office Vacancy Rates



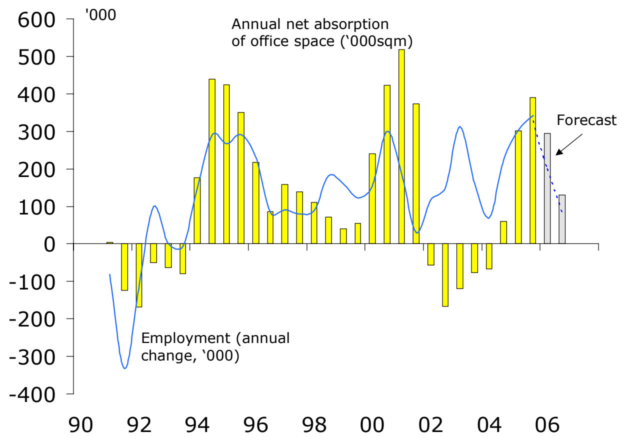
Source: Property Council of Australia

While tighter conditions are not fully reflecting in face rents, *effective* rents are improving via a winding back in incentives.

However, with jobs growth set to slow sharply, net absorption for office space will fall significantly over 2006, offering a timely reality check for a market that is threatening to undergo a 'mini-boom'. There is evidence of a construction response to improved fundamentals with office building approvals up 80% in year to the October quarter 2005. Victoria and Queensland, in particular, appear to be preparing a solid increase supply levels over the medium-term. Given generally long lead times, supply levels should not be a threat to fundamentals in the short-term.

On current planned activity levels and on realistic assumptions about absorption going forward, **Brisbane's** CBD vacancy rate must rise, albeit from low levels, as the prospective addition to stock ratchets up to high levels over the next couple of years. Despite a firming in face rents and falling incentives, the **Melbourne** CBD office market remains vulnerable. Both Melbourne and 'Adelaide core' markets are likely to experience higher vacancy rates in the coming year. On the other hand, Sydney and Perth markets appear to be on a firmer footing. In these two markets even an extreme assumption of zero net absorption over the next few years would do little to vacancy rates, reflecting primarily, a moderate supply response so far. While these conditions are not yet reflecting in higher face rents, very strong investor interest is firming yields. Clearly, the Perth market has a more accommodating economic fundamental (commodity prices) and therefore is more likely to sustain a strong run compared to a faltering NSW economy.

Absorption will slow next year



Source: Property Council of Australia, Economics @ANZ

Absorption is forecast to slow from around 390,000 sqm per annum (5 state capitals) to 130,000 sqm over the coming year. This will see the corresponding vacancy rate lift from 8.3% to well over 10% by mid 2006, serving as reminder that imbalances may be re-emerging.

Importantly, however, provided the current construction upturn remains within a reasonable range, this imbalance will prove to be temporary. The prospect of an improving labour market in 2007 should 'validate' construction entering the pipeline and be easily accommodated.

[6] Property Council of Australia

A continued marginal firming in yields would not surprise over the coming year despite a moderate interest rate rise and slower absorption. Investor interest will look to higher yielding alternatives and investment flows will be providing considerable liquidity to what is typically a very tightly held market.

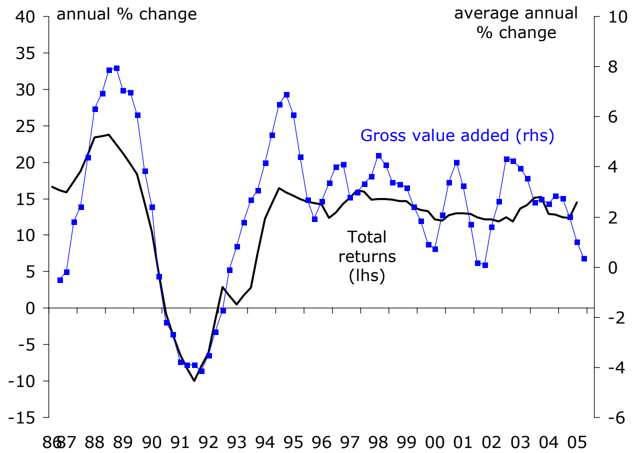
Industrial

Despite a dismal economic performance by the manufacturing sector, industrial property markets have strengthened in the past 6 months, with total returns rising to 14.5% over the year to June. Growth is being driven by a scarcity of warehouse space and growing demand for retail distribution facilities.

Continued solid institutional demand for industrial property has seen yields tighten further in both prime and secondary markets.

Increasing import penetration combined with a strong currency in recent years has heightened competitive pressures facing the domestic manufacturing sector. But despite a marked slowdown in total retail spending in the past year, increased demand for warehouse facilities has maintained downward pressure on industrial property yields.

Returns up despite weak manufacturing



Source : Property Council, ABS

Firming yields and high capacity utilisation have driven a surge in new development activity. Industrial building approvals rose 38% in year average terms over the year to October. Factory approvals are up by a modest 11.2% while warehouse approvals have increased by 61%. New industrial building activity has been strongest in New South Wales, Victoria, Queensland and South Australia.

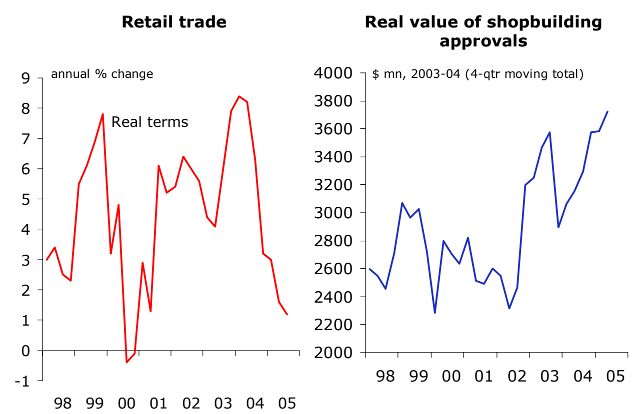
Retail spending is forecast to strengthen moderately in 2006 and an expected weakening of the $A should provide some relief for the beleaguered manufacturing sector. Despite strong new building activity in recent years, capacity utilisation remains at high levels and the broad outlook for the industrial property sector remains sanguine.

Retail

Retail sales have slowed considerably this year from the above-trend rates of expansion experienced over the past three years. For the first nine months of this year, turnover, in real terms, grew by just 2% compared with the same period in 2004. The outlook is for a slight pick-up in turnover in 2006 to around 3% (still below trend). The upturn is premised on a pick-up in disposable income growth underpinned by solid wage growth, further tax cuts as well as a softer fuel price outlook and a modest pick-up in house prices over 2006.

Despite the lower sales trajectory over 2005 and 2006 and strong pipeline of supply, relatively low vacancy rates provide support for further rental growth, albeit at a slower rate. CBD rents are expected to hold steady reflecting the limited new supply and strong tenant demand underpinned by growing inner city residential and worker population and a relatively healthy outlook for overseas visitor arrivals. Suburban shopping centres will continue to be supported by rapid growth in residential development in the outer fringe in the recent past. But new floorspace following the completion of expansion projects in existing centres and new neighbourhood centres will limit rental growth.

Retail turnover slows but approvals stay strong



Sources: ABS, Economics@ANZ

The bulky goods market has grown at an aggressive pace in recent years, buoyed by the housing boom. Tenant demand is likely to stay strong with national chains looking to secure greater market share but lower growth in turnover for household goods compared with the strong run over the past four years, and a substantial amount of new supply coming into the market over the next two years are likely to limit rental growth over the medium term.

Retail trade performance in New South Wales is expected to lag the national average in 2006 as it has over the past few years as sluggish population and employment growth have impacted spending. Vacancy rates in the CBD are relatively low but are likely to edge up over 2006. Together with the coming on stream of new supply (eg. expansion of shopping centres and new supply in the bulky goods sector), rents are likely to come under some downward pressure. Projects expected to commence in 2005/06 include Rhodes Waterside retail development and Coles Myer Distribution Centre, Blacktown.

The sharp increase in supply of Melbourne CBD retail floorspace over 2005-2006 as well as the refurbishment/expansion of suburban shopping centres are expected to exert downward pressure on rental growth over the medium term. However, an increase in the number of inner-city residents and worker population as well as a lift in tourist arrivals are likely to support the retail sector and limit the adverse impact on rents from additional supply. Major development projects include Westfield Doncaster and Chadstone retail developments, and Tooronga Homemaker Centre.

Solid population growth in Queensland - growing at twice the rate of the national average - and strong State economic growth are likely to underpin the retail property market although the sharp slowing in retail turnover in Queensland in 2005 suggests that rental growth is not likely to be as strong. Brisbane CBD retail is likely to continue to enjoy solid tenant demand driven by strong inner-city residential population growth and strength in the office market.

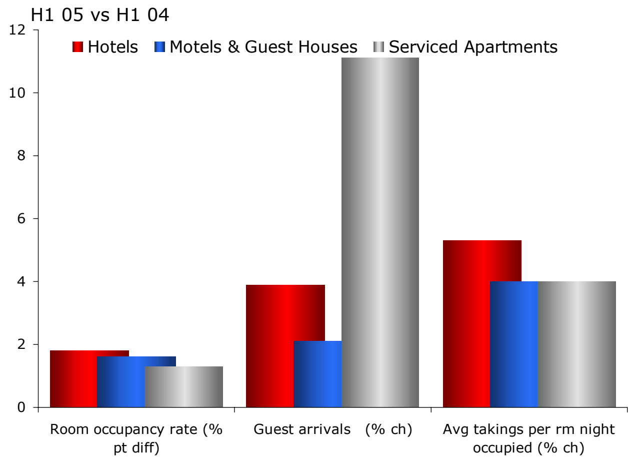
Higher quality stock as a result of redevelopment and refurbishment projects across smaller regional centres in Adelaide will benefit the retail property sector. However, the scope for rent growth is impeded by sluggish retail sales growth, reflecting the difficult manufacturing environment and softness in the housing market. Retail trade, grew by 0.7%, in real terms, during January-September 2005 compared with the same period in 2004 - the weakest growth across the States and Territories.

The retail property market in WA remains vibrant. Projects such as the upgrading of Hay and Murray Street Malls (underway) and railway development will draw more people into the city and will help to lift CBD retail sales growth. New mixed office/retail developments in the CBD have also been proposed. With the WA economy continuing to post robust growth in 2006 and the unemployment rate expected to remain the lowest after the ACT, retail spending is likely to continue to be higher relative to other States in 2006.

Tourism accommodation markets

After some tough operating conditions in the recent past, the tourism accommodation sector has witnessed a reprieve in 2005. The outcome is likely to have been better if not for the impact of high oil prices. Average takings per room night occupied rose by 4.6% compared with the same period in 2004. Guest arrivals were up 4.3% and the occupancy rate averaged close to 60% in H1 2005 - strong compared to previous corresponding periods. This is in spite of an additional 159 establishments coming into the market in the first half of this year. Hotels have recorded a further recovery in terms of occupancy levels and room rates and serviced apartments have done particularly well given the sizeable increase in the number of establishments. Even motels, which have been under pressure in recent years being in the "middle" of the market (i.e. having to compete with hotels and serviced apartments, on the one hand and bed & breakfasts and caravan parks etc, on the other) recorded much-improved trading conditions.

The tourist accommodation market improves



Source: ABS

The accommodations sector has clearly benefited from relatively healthy international tourist arrivals, which grew by 6.9% during January-October 2005 against the same period in 2004. The market has been lifted by the increasing use of the internet as travellers take advantage of low cost airfares and hot deals on accommodation.

The outlook for overseas visitor arrivals looks promising with the Tourism Forecasting Committee predicting growth of around 5.6% per year over 2006-07. Main risks, however, include heightened security concerns and the outbreak of a virus in the region (eg. as in the case of SARS and current concerns of a widespread incidence of bird flu), which would severely reduce overseas visitor numbers.

Domestic travel, in terms of overnight trips, has been down slightly according to the Bureau of Tourism Research. During the year ended June 2005, Australian residents made 72.2 mn overnight trips, 3% less than the previous year. However, Queensland and the Northern Territory saw a sharp increase in interstate visitors during this period.

In terms of supply, building approvals for the first nine months of this year were down marginally by 1.3% compared with the same period in 2004, signalling some moderation in building activity ahead. Approvals data suggest that Western Australia, Tasmania and the ACT are likely to see a pick-up in construction activity while New South Wales, Victoria, Queensland and South Australia are expected to see some winding back of activity.

New South Wales hotel building approvals during January-September 2006 were down about 10% from the same period in 2004. With refurbishment of major facilities nearing completion and limited scope in terms of suitable land available for new development, construction activity in this sector is expected to soften. Occupancy rates are likely to continue to climb from the current high rates of over 70%, creating upward pressure on room rates.

Melbourne’s strong events calendar (Australian Open, Commonwealth Games, Grand Prix, Volvo Ocean Race) is expected to attract sharply higher visitor numbers to the State in 2006, particularly in the first quarter. Accommodation operators are likely to face near full occupancy and command significantly higher room tariffs but post Commonwealth Games will see a return to more “normal” rates. Victoria has experienced a strong accommodation construction phase over the recent past and a winding back of building activity is expected over 2006.

Queensland’s tourist accommodation sector is likely to continue to benefit from growing interstate travel. The occupancy rate was 62% in Q2 2005, the highest rate by historical standards. Strong demand from both domestic and international visitors is likely to keep upward pressure on room rates, despite additional supply in the pipeline.

Limited supply coming on stream in Adelaide, and steady demand, should provide scope for a further improvement in room rates and occupancy levels. Average takings per room night occupied were up by 0.8% in H1 2005 compared with H1 2004.

Demand in Perth is likely to stay strong. The resources boom and healthy business investment will continue to lift domestic corporate demand for accommodation. Increased competition from regional operators offering discount airfares to Perth are also likely to boost international visitor arrivals over 2006.

While competitive airfares are likely to boost visitor numbers to Tasmania over 2006, the coming on stream of new supply is expected to limit the scope for a further strengthening in room rates.

The Darwin tourist accommodation sector is expected to continue to benefit from an increase in airline capacity, which will lift interstate travel. During the year ended June 2005, there were 608,000 overnight trips taken by interstate visitors to the NT, up 27.7% from the previous year. Visitor nights by international travellers are also likely to pick up, underpinned by overseas marketing efforts.

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