

AUSTRALIAN PROPERTY AUSTRALIAN PROPERTY OUTLOOK

JUNE 2011

INSIDE

Economic Overview.....	2
Residential Property.....	3
Office Property.....	8
Retail Overview.....	9
Tourist Accommodation...	10
Industrial Property.....	11

CONTRIBUTORS

Paul Braddick
Head of Property Research
+61 3 9273 5987
Paul.Braddick@anz.com

Mr. Ange Montalti
Senior Economist, Property Research
+61 3 9273 6288
Ange.Montalti@anz.com

David Cannington
Economist,
Property Research
+61 3 9273 4274
David.Cannington@anz.com

Dylan Eades
Analyst,
Property Research
+61 3 9273 2708
Dylan.Eades@anz.com

TESTING TIMES AHEAD

ECONOMIC OVERVIEW

For Australia, the driving medium term economic thematic remains the looming surge in mining and resource investment. In an economy with little spare capacity, the investment boom presents considerable upside risks to wages, inflation and interest rates.

RESIDENTIAL PROPERTY

House prices will be tested with further interest rate rises in prospect. But observed weakness will prove transitory as rental re-alignment occurs, instilling renewed confidence and creating the market conditions for a moderate price recovery. While sentiment may win the battle in 2011/12, fundamentals will win the war.

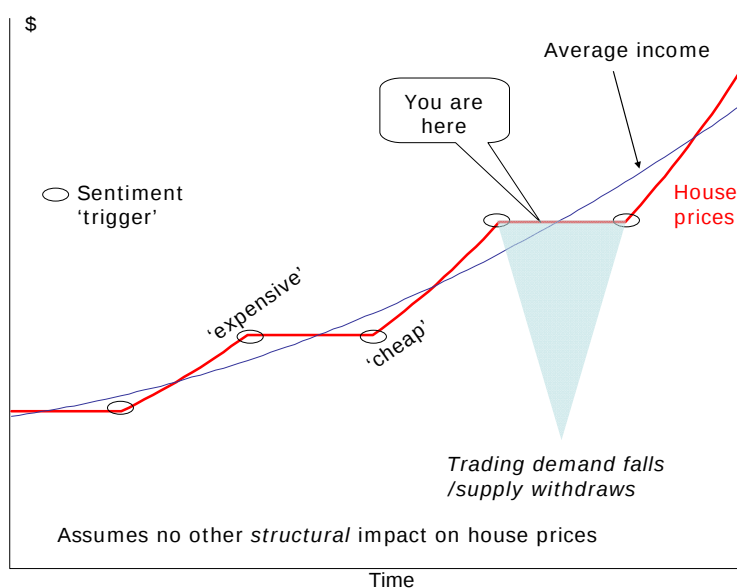
COMMERCIAL PROPERTY

The **office** market is finding its feet. Further yield re-compression in the short-term will meet resistance with rentals being the next catalyst for shifts in capital values and building activity. On this score, conditions vary markedly across the capital cities.

Retail property enjoys strong fundamentals, offering a good buffer against short-term tenant vulnerabilities. Nonetheless, soft retailing conditions warrant a 'tread carefully' strategy over 2011/12.

While **industrial** property yield compression has slowed in the first quarter of 2011, strong market fundamentals with renewed demand for industrial space present a favourable outlook for industrial property. Although conditions are showing signs of improvement, the **accommodation** sector continues to struggle, with the higher A\$ weighing on demand.

STYLISTED HOUSE PRICE CYCLE UNDER 'NORMAL MARKET' CONDITIONS



Source: ANZ

ECONOMIC OVERVIEW

MINING BOOM TO DRIVE AUSTRALIAN GROWTH

GLOBAL RECOVERY CONTINUES

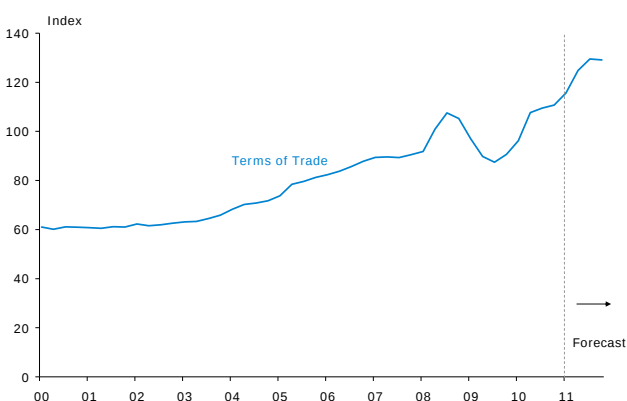
Political turmoil in the Middle East, burgeoning Asian inflation and ongoing European sovereign debt concerns all present risks to the global outlook. However, extremely accommodative monetary policy settings will continue to drive recovery in the advanced world. Rapid (albeit slowing) growth in Asia and modest recoveries in the US and Europe will ensure global growth remains solid at around 4.5% in 2011 and 2012, providing a strong backdrop for Australian exports and commodity prices.

AUSTRALIA: RATES SET TO RISE

Natural disasters, weak credit growth, softening house prices and fragile household sentiment restrained Australian economic growth in 2010. Moreover, prospective interest rate hikes will weigh heavily on housing affordability and consumer sentiment and will further restrict household cash flow in the year ahead.

However, the driving medium term economic thematic remains the looming unprecedented surge in mining and resource investment. The terms of trade is at record highs and is forecast to push higher in the second half of the year. This underpins a record \$83bn in planned mining investment in the year ahead. In an economy with very little spare capacity, such an investment boom presents considerable upside risks to wages and inflation.

COMMODITY BOOM PRESENTS RISKS TO INFLATION



Sources: ABS, ANZ

Strong employment gains in recent years have pushed the unemployment rate below 5% and skilled labour shortages are already apparent in several sectors.

Buoyant labour demand and reduced net migration suggest the unemployment rate will fall towards 4%, well below the widely accepted NAIRU¹ of 5%. Hence, the risk to wages and inflation remain skewed to the upside and the RBA is justifiably concerned.

'Mildly restrictive' monetary policy at present will be insufficient to prevent an acceleration of inflation and given its experience in 2008, the RBA is keen to remain 'ahead of the curve'.

Therefore, despite subdued household spending, a strengthening A\$ and tightening fiscal policy, we continue to expect further official rate hikes totalling 100bps over the next 15 months. Despite a healthy outlook for employment, wages and household incomes, ongoing interest rate hikes will effectively maintain a cap on retail spending and house prices over this period.

DWELLING INVESTMENT SUBDUED

New dwelling approvals have weakened substantially over the past year following a normalisation of public home building activity and a sharp decline in private house approvals. This has been partially offset by a surge in medium and high density development, particularly in Melbourne. Flat to falling house prices and rising interest rates will continue to weigh on builder sentiment in 2011/12 and new dwelling supply will remain well short of underlying housing demand in most states. Combined with an emerging rebound in net overseas migration, subdued new home building activity will drive a further tightening in the housing market balance.

NON-RESIDENTIAL BUILDING TO FALL

Non-residential building activity will soften in 2011/12 as building associated with the Government's \$42bn stimulus package is completed. Private building approvals have weakened sharply and supply additions for shops, offices, factory/warehouse and hotels will all be very subdued in the year ahead. Despite a marked improvement in underlying commercial property market conditions, developer sentiment remains cautious and access to finance continues to be a key constraint.

¹ Non-accelerating inflation rate of unemployment

RESIDENTIAL PROPERTY

THE BATTLE-LINES ARE DRAWN

SENTIMENT VERSUS FUNDAMENTALS

House prices have flattened over 2010/11. The removal of the first home owner boost, a re-tightening of foreign investment rules and rising interest rates (particularly the '40 basis point' hit) in November 2010 have been the front-line triggers that have shifted the market trajectory. At the same time, we have witnessed a near-halving of net overseas migration, which has reduced underlying housing demand. A series of natural disasters have also weighed in, distorting underlying price patterns in Queensland.

Vacancy rates have risen in some cities, auction clearance rates and the demand for finance has softened. Forward indicators of building are very weak. Importantly and not surprisingly, sentiment has shifted too.

The prospect of rising interest rates will drive a further deterioration in affordability in 2011/12 but the risk of *significant* falls in house prices remains remote.

Buoyed by the resources boom, the Australian economy is forecast to expand at an above trend rate in 2012. The labour market will be well supported; unemployment will fall and skilled labour shortages will place further upward pressure on wages. Consequently, 'forced' selling of homes will remain at low levels.

In addition, the housing market will continue to tighten as new home building again falls well short of underlying housing demand. Already low rental vacancy rates are expected to tighten further and will place upward pressure on rents and improve yields. This will be exacerbated by floods in Queensland that have severely damaged many properties and displaced many households.

Nonetheless, rising interest rates, deteriorating affordability and the absence of an upside trigger to improve sentiment will keep house prices in their current range over 2011/12.

BEWARE OF SIMPLE MEASURES

Discussion about whether house prices are overvalued and calculating 'by how much' is often founded on single-dimensional metrics using long-run averages as reversion targets. Sometimes, the ratios used are ill-founded e.g. 'debt to GDP' or 'house price to income'. Even the slightly more complex affordability-based measures and rental-discount models are afforded too much status as if they capture *all* the information required to explain price outcomes.

More sophisticated econometric techniques that include a range of drivers acknowledge that there is more at work in the market place and that single-dimensional measures alone won't do all the explaining. That said, while econometrics offers some value, the technique has significant shortcomings, not least of which is the inability to capture the impact of major structural shifts (i.e. deregulation).

The aim of house price analysis should not be to simplify relationships (e.g. assume reversion to long-run averages) and then imply that the discrepancy *must represent* 'over-valuation'. Rather, the strategy should seek to validate observed price outcomes by internalising a broader set of drivers and making an assessment of how each of these will play out. While many of the 'extra' drivers are not quantifiable, assigning the direction and power of influence to particular drivers does allow for a more robust interpretation of what has happened to house prices to date and what is likely to happen in the future.

HOUSE PRICES ARE STRUCTURALLY SOUND

A distinction needs to be made between *structural* influences (e.g. a lasting regulatory change or a 'permanent' shift in the cost of funds) and *cyclical or transitory* influences (e.g. temporary policy shifts or a within-cycle movement in interest rates). *Incomes represent the most stable of structural influences for benchmarking house prices.* That average household incomes have continued to rise over time, provides a solid basis for house prices to grow. If house prices had risen by the same percentage as average household incomes over the past quarter of a century (i.e. a constant house price to income ratio), the median price in 2011 would be around \$310,000 instead of \$554,000. A reversion to some historical 'house price to income' ratio suggests house prices need to fall some 44%. However, the fall in inflation and interest rates through the 1990s was another momentous *structural* shift that must be internalised in any analysis of house prices.

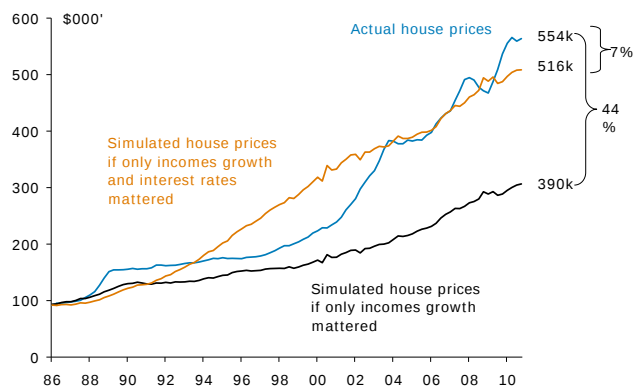
If it were *just* interest rates and incomes that mattered to the determination of house prices (and 1985 is used as a benchmark for sustainability²), one could argue house prices need to fall by 7% from March quarter 2011 levels.

² 1985 was about two years after recession and well before any hint of the ensuing boom in house prices. It is also an economic cycle mid-point before the impact of deregulation and before structural falls in interest rates and inflation.

AUSTRALIA

But there are more structural influences *other* than interest rates and incomes growth that have played out over the past two decades including financial deregulation, tax changes and more recently, a chronic shortage of dwellings. These influences all support a structural lift in house prices that is above and beyond that explained by incomes and interest rates. There are no obvious *structural* grounds upon which to validate a *significant* correction in house prices.

INCOMES AND INTEREST RATES VALIDATE PRICES



Sources: RP Data-Rismark, ABS, ANZ

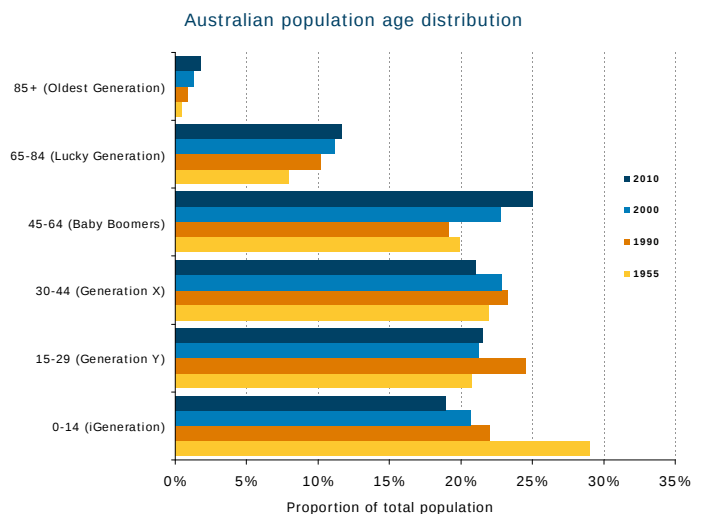
MODERATION AHEAD

Looking ahead, the transitory forces are delicately poised, with interest rate and sentiment headwinds taking centre-stage for the time-being and we expect more of the same for 2011/12 as higher interest rates and more muted capital growth expectations play out against supportive economic and housing market fundamentals.

While prices will be tested by transitory influences, structural supports remain intact. Firstly, *incomes* are set to grow solidly over the medium-term, facilitating affordability. Secondly, *inadequate supply-side policies* will embed a 'shortage premium' in house price structure. Indeed, it is arguable this premium is yet to reflect in values and will do so initially via rental market signals. *Lending practices* and *taxation provisions* are not expected to shift the underlying economics of house prices with the bulk of these changes having already filtered through the system over the past two decades. Similarly, the greater number of dual income households has boosted servicing capacity and hence affordability and house prices. While this structural shift may have run its full distance, by the same token, it's unlikely to reverse. It is not a stretch to argue that these structural influences, while being important drivers of solid house price growth over recent decades present now as neutral influences for the one ahead.

Lastly and deserving more attention, net divestment of housing by 'baby-boomers' unsatisfied with prospective returns has been put forward by some as the 'Achilles heel' for the housing sector. This argument is intuitively appealing but overplayed. Portfolio re-allocation for pre-retirees and retirees is not new. While it is likely to occur in larger than usual numbers (given there are so many 'boomers') it is still very likely to be a gradual process, blurring across age categories and over a long period of time. Critically, while baby-boomers represent 25% of total population, there are more Generation-Xs and Generation-Ys combined, suggesting the demand-side will be 'open for business'. Given only a very small proportion of this population stock engages the housing market at any point in time, there is fickle ground for suggesting net divestment will be a *significant* market mover (if at all). The likely price driver over the medium-term in this context will be the average income levels of Generation 'Xs' and 'Ys' who are in the prime home purchase (owner-occupier and investor) life stage.

DEMAND SIDE IS 'OPEN FOR BUSINESS'



Sources: ABS, ANZ

In summary, the economy is on a healthy trajectory and conditions in the housing market are tight and likely to tighten further in the years ahead. House prices will be tested with further interest rate rises in prospect. But observed weakness will prove transitory as rental re-alignment occurs, instilling renewed confidence and creating the market conditions for a moderate price recovery. *While sentiment will win the battle in 2011/12, fundamentals will win the war.*

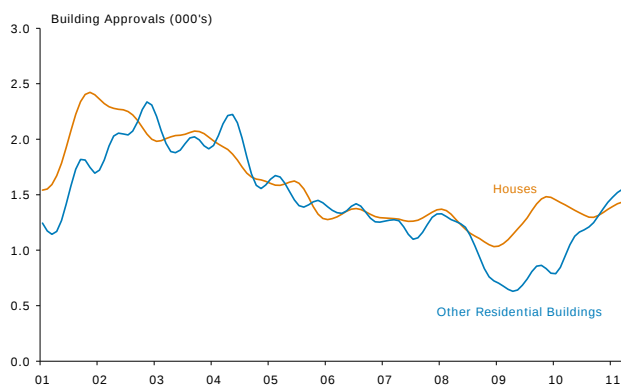
RESIDENTIAL PROPERTY

NEW SOUTH WALES

Sydney's housing market has softened over the past six months, with house price growth slowing to 1.5% over the year to March 2011. Activity has weakened and clearance rates are currently hovering at 50%-55%, well short of the rates recorded over 2009/10. Despite slowing, prices will remain underpinned by healthy economic conditions. The state economy is forecast to expand by 2.5% in 2010/11 and 3.0% the following year, exerting further downward pressure on the unemployment rate, which is already sitting at 5%. However, continued monetary policy tightening and deteriorating affordability will provide headwinds, capping house price growth. As such, we expect house prices to largely move sideways over the next two years.

Even though NSW has added, on average, almost 75,000 people a year over the past decade, housing completions have declined from 51,500 in 1999/2000 to just 25,500 in 2009/10. Excessive infrastructure costs and government policy have exacerbated the housing shortage in NSW, which we estimate will reach 126,600 by mid-2011. The chronic housing shortage in conjunction with the relatively healthy economic outlook will intensify pressure on the rental market. Vacancy rates look set to fall under 1% by the end of the year – to their lowest rate on record. A sharply tightening rental market, foreshadows a period of substantially stronger rental growth over the years ahead.

BUILDING APPROVALS ARE ON THE IMPROVE



Source: ABS

A positive development over the past 18-24 months has been the marked improvement in building approvals. Having bottomed in February 2009, building approvals have increased by 71%, with most of the up-tick originating in the "other residential buildings" sector (apartments and units), spurring a 19% rise in completions over 2010-11 to 30,300.

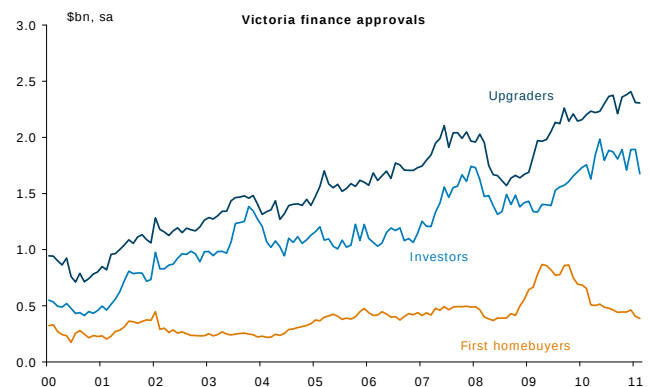
This suggests that a greater emphasis is being placed on medium to high density developments. Despite the recent improvement, by historical standards, completions still remain at depressed levels, some 41% below their peak in 2000.

VICTORIA

While recent softness in Melbourne's housing market has shown that it's not indestructible, it has continued to perform strongly relative to other capital cities. Solid growth in economic activity and employment, led by significant infrastructure investment through 2010, underpinned residential property price growth of 9% in the year to December compared to 5% nationally. In the year to March 2011, Melbourne property price growth slowed to 1%, while house prices across all capital cities were 0.6% lower.

Despite a recent softening in house price growth, positive economic conditions should continue to support Victorian housing market activity through the remainder of 2011. Trend unemployment has fallen from 5.4% to 4.7% over the past year, household disposable income continues to show solid growth and the Victorian economy is expected to grow by 2.0% and 2.5% over 2010-11 and 2011-12 respectively.

UPGRADER ACTIVITY CONTINUES TO IMPROVE



Source: ABS

Despite strong growth in dwelling construction in Victoria through 2010, driven largely by strong demand for medium density housing (flats/units/townhouses), the recent moderation in population growth and weaker building approvals indicate that dwelling construction activity will soften through 2011 and into 2012. While the recent construction boom provided a modest easing of Victoria's tight underlying housing market balance the outlook for slower growth in housing supply is expected to add further pressure to the housing shortage in Victoria.

RESIDENTIAL PROPERTY

Nonetheless, ANZ Research analysis suggests a significant supply pipeline presents some challenges for inner Melbourne apartment market, that could potentially undermine the existing tight inner-Melbourne market conditions.

QUEENSLAND

The natural disasters at the beginning of the year, and the softer economic conditions have had a palpable impact on the Queensland housing market. Finance approvals have continued to trend southwards, falling by 22% over the past year, while building approvals have fallen 18.7% since November (after showing signs of improvement during early-2010). Not surprisingly, these localized factors, in conjunction with monetary policy tightening over 2010, have seen property prices fall by 6.8% over the year to March 2011.

Although new high-end apartment stock on the Gold Coast has been sold at substantial discounts, existing residential stock has held up relatively well. Indeed, the most recent Residex data, shows that unit prices have held up relatively well along the Gold Coast over the past year.

In the near term, weak economic prospects will provide little support to the housing-market. Natural disasters and the higher A\$ continue to weigh on the tourism sector. Furthermore, initial estimates suggested that as many as 25,000-30,000 homes would have to be rebuilt, but this number now actually looks closer to 4,000-5,000. As a result, the rebound will be quite muted and will have only a minimal impact on housing construction and activity in the market.

As such, we expect further declines in Brisbane property prices over the next 12-18 months, with tight market fundamentals minimising the fall in prices. Over the medium term, recently approved mining and resource projects, will provide some impetus to the economy and house prices.

SOUTH AUSTRALIA

South Australia's residential property market could be described as the "Goldilocks" market. House price growth has been solid; neither poor nor exceptional, housing affordability remains comfortably below the national average and rental vacancy rates have gradually eased to 1.0% through 2010.

With moderate economic growth (2.0% through 2010-11) and the strong Australian dollar presenting tough conditions for manufacturing businesses competing in a global market, expectations are for only a modest acceleration in SA economic growth in 2011.

Consequently, Adelaide's annual house price growth has slowed to 0.9% and we are expecting house prices to drift sideways through 2011.

Following strong growth in new housing supply in the first half of 2010, South Australian building approvals and starts have weakened, decreasing by 13% and 11% respectively over the year to December 2010. While softer building activity will provide a drag on economic growth, it will put upward pressure on rental growth given the tight conditions of the rental market and a weaker supply pipeline of new housing. In contrast to other states, the existing 'balance' in South Australia's housing market suggests underlying pressures on house price growth are not as prevalent.

WESTERN AUSTRALIA

Western Australia's economy continued to ride the wave of the post-GFC commodity boom through 2010 and early 2011. Through 2010, WA employment increased 3.4% on average in annual terms, household disposable income was up 10% and economic growth increased 5.0% (in 2009-10). Despite this, house prices have underperformed other states with Perth experiencing a fall in house prices of 6.3% over the year to March 2011. This is a significant decline compared to the recent peak of 11.9% annual Perth house price growth as recently as February 2010. Other parts of Western Australia have experienced similar, albeit less extreme volatility.

Rental vacancy rates have remained elevated (3.9% at December 2010) compared to other capital cities, although have started to tighten in the second half of 2010, reflecting a housing market that is still struggling to keep pace with the broader economy. Looking through the transitory weakness of the WA residential property market, expectations for strong economic growth and income gains - as the significant mining presence benefits from elevated commodity prices - should support house prices. With the existing underlying shortage of housing expected to continue building through 2011 and beyond, the underlying market fundamentals should provide additional support to growth in WA house prices in the medium term and housing market activity in the years ahead. In the meantime, the current housing market weakness presents favourable conditions for both home buyers and renters.

RESIDENTIAL PROPERTY

TASMANIA

Like its counterparts on the mainland, Hobart's housing market has softened over the past six months. House prices declined by 1% over the year to February, broadly in line with national performance. However, units have noticeably underperformed, and are now 15% below their peak recorded in March 2010.

Economic conditions remain soft. The unemployment rate is currently sitting at 5.7% - the highest in the country. However, there are tentative signs of improvement. In December, business investment expanded for the first time in 18 months, whilst consumption has begun to accelerate. Improving economic conditions should boost confidence in the market, minimising further price declines.

Indeed, housing market activity has begun to stabilise. Building approvals have increased 4.1% over the past quarter and remain at very healthy levels. As a result, completions will remain elevated ensuring that Tasmania's housing market remains in balance over the medium term. This should keep vacancy rates fairly stable, restraining rental growth. Nonetheless, weaker capital growth will continue to support rental yields which we expect to remain above 5.0% - the highest in the country.

NORTHERN TERRITORY

House price growth has stalled recently, with prices falling by 1.3% over the year to March. Although broader macroeconomic conditions (rising interest rates, cautious consumer) have weighed on the market, Darwin's underperformance is largely a result of softer state economic conditions. A number of important resource construction projects (GEMCO manganese refinery and Eni Blacktip gas project) were completed in 2010. Given that the mining and construction industries account for almost 35% of the economy, fluctuations in activity in these sectors, creates substantial volatility in the economy.

Net interstate migration flows have reversed as a result, and the NT has gone from adding almost 1200 people per year to losing just over 1100 people. This has taken some pressure off rental growth which has moderated to 3.7% in December from a peak of 13.5% in March 2009. Meanwhile, construction activity has continued to subside, with building approvals falling by 27.8% over the past year to March.

As a result, we are forecasting completions to fall by 4.8% in 2010-11 and a further 10.8% in 2011-12, resulting in a further worsening in NT's housing shortage. These strong housing market fundamentals and relative affordability will put a floor under house prices, preventing significant price falls. Furthermore, the Ichthys liquefied natural gas project expected to receive approval at the end of the year, which should provide impetus to the economy and house price over the medium term.

AUSTRALIAN CAPITAL TERRITORY

Canberra's property market remained a solid performer through 2010. With a trend unemployment rate of just 3.2% at March 2011 and solid household income gains, the outlook for Canberra's housing market remains sound.

Despite average annual house price growth of 13.5% in 2010, Canberra's housing market remains the most affordable relative to household income of all Australian capital cities.

In contrast to most capital cities, Canberra's housing supply has experienced a mini-boom in response to the ACT government's release of over 4,000 sites for development activity over 2009-10 and in excess of 5,000 sites over 2010-11. Through 2010 average annual dwelling starts increased 54% (compared to 23% nationally) with strength continuing into 2011. This strong growth pattern doesn't appear to be easing significantly, with dwelling approvals increasing 6.0% in the 3 months to March 2011.

The boom in ACT construction has not been matched by growth in housing demand. Housing finance approvals have remained subdued (9.9% lower in the 3 months to March 2011) while underlying demand has been slowly moderating. The net impact on the housing market balance has been to ease the pressure on an underlying housing shortage, that is estimated to be around 1,400 dwellings at June 2011.

OFFICE PROPERTY

HIGHER RENTALS NEEDED FOR CONSTRUCTION

VACANCIES ARE TIGHT

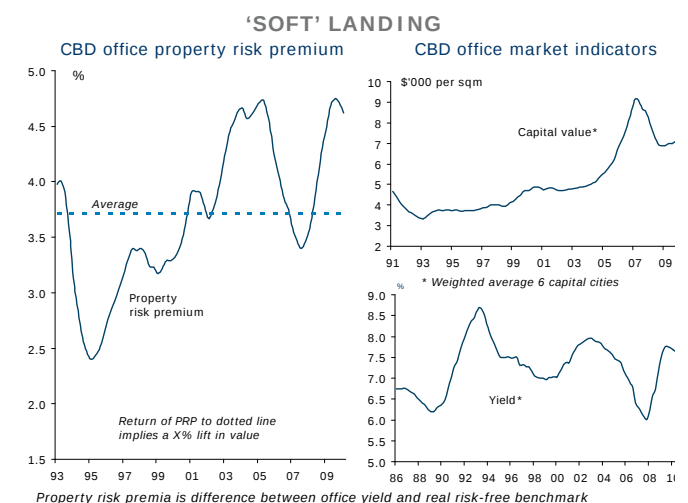
The office market is benefitting from robust fundamentals. Capital values have generally stabilised and are up around 6% since troughing in 2009³. Rentals have also bottomed but considerable variation remains across capitals, reflecting among other things the unique condition and trajectory of *individual* office markets in the lead-up to the GFC.

The office market finding its feet so soon after a “one in 100 year” financial shock reflects good luck. That the GFC and rising interest rates through 2008 occurred ahead of any substantial build-up in new office supply averted what was shaping up to be a typical boom/bust activity cycle. The impact on the office market can be characterised as a ‘one in ten year’ event, a kind of mini-cycle where vacancy rates have generally remained in single digits. Demand conditions remained relatively buoyant while the life blood of the supply-side – finance – was scarce, more discerning and more expensive.

Funds (both debt but mainly equity) are flowing more readily in 2011 and transaction activity has lifted. This is symptomatic of a renewed level of comfort in market conditions and suggests some price discovery is occurring. The market now feels more confident about making assessments of value and future value. Unfortunately, the economics for a seismic shift in sentiment does not yet stack up which is one reason the supply pipeline is not building. While yield re-compression has started and will continue in ‘baby steps’, rental realignment is the other leg that needs to mobilise for the development equation to make sense across a greater number of proposals and to mobilise values more generally. The good news is that persistent tightness in office markets should begin to signal this realignment over the next couple of years, bringing with it the seeds of the next building cycle.

Sydney's CBD office market is tightening moderately with vacancies beginning to trend down towards 7%. Capital values and rentals are so far only hinting at rallying. A further tightening in demand/supply conditions is expected to prompt solid rental growth and continued firming in yields over the next two years. But for the risk of continued economic under-performance, such conditions will be providing a strong foundation for higher capital values. **Melbourne's CBD office** market is very well placed for strong returns over the next few years.

Persistent employment growth has maintained healthy absorption levels and has facilitated a notable decline in vacancies in the last six months. Rentals have been remarkably stable compared to the other Eastern seaboard capitals but are still sitting at a sizeable discount against these centres. Yields have firmed, underpinning the 18% lift in capital values since late 2009 but an expected rental re-alignment together with further yield compression suggests this market has further to run. **Brisbane's CBD office** market will cope despite economic under-performance. Limited new supply has seen historically high vacancies fall decidedly in the past 6 months even on weak absorption. After a doubling over 2007, rentals have plummeted to still healthy levels but sustainability will be tested if the economy does not perform. Rentals and capital values growth will be subdued at best. Renewed commodity sector strength has averted a dangerous build-up of excess supply in the **Perth CBD** office market with vacancies edging down even with a healthy supply side. Rentals and values have collapsed following the GFC, re-aligning towards a more sustainable level. Given favourable prospects for the WA economy, rents and prices will have considerable support at these levels. A healthy run-up in **Adelaide CBD** rentals even through the GFC and generalised yield compression has provided an extra ‘kick’ in office values (up 18% since 2009). Vacancies are steadying and economic growth prospects are benign but not startling, suggesting a slowing in total returns is likely in the years ahead.



Source: JLL, IPD, ANZ

³ Weighted average of 6 capital cities (JLL data weighted by ANZ Research)

RETAIL PROPERTY

A HARD SLOG

Persistent weakness in consumer spending, a strong dollar and a notable 'gear shift' in on-line shopping practices have combined with interest rate rises to define the next chapter for retailers in a post-GFC environment. A spate of natural disasters on top of the generally subdued atmospherics has generated short-term uncertainty for policy makers. These conditions expose the most vulnerable elements of the retail sector, cutting across all sub-sectors but generally imposing upon those with poor balance sheets, out-dated business models and product lines. An expected reticence among consumers over 2011 will place ongoing pressure on the most vulnerable operators. By the same token, opportunities present for innovative retailers who adapt business models to shifting consumer preferences.

Luckily, the property market implications of an evolving retail operator landscape, while important, are not revolutionary. Market rentals will continue to be driven primarily by vacancies. Yields and capital values will be influenced by broader financial market developments including finance availability, shifts in general risk aversion and asset allocation.

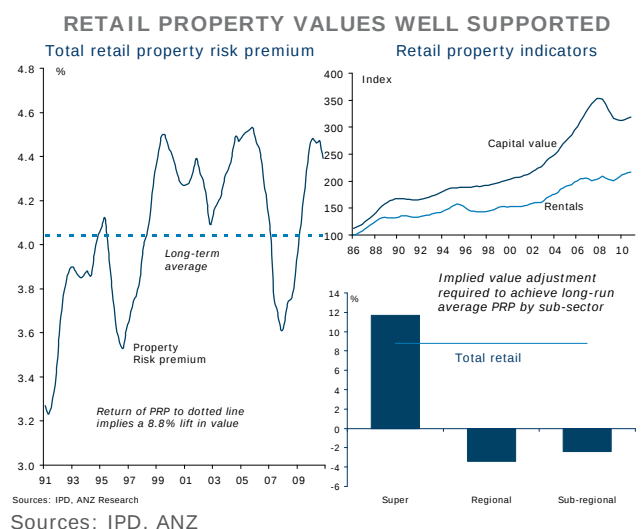
Retail property indicators suggest a strong fundamental position. This should offer a good buffer against short-term tenant vulnerabilities. Capital values have bottomed and rentals are accelerating. Vacancy rates are generally low with some exceptions (e.g. CBD Perth and Canberra and neighbourhood Adelaide have above average vacancies). Low vacancies suggest demand for space is keeping pace with new supply which has been subdued over 2010. A bounce in retail building approvals through 2010 for delivery in 2011/12 suggests market headwinds may develop, but this is likely to present only if retail spending remains flat for an extended period. This is an unlikely scenario with incomes expected to underpin consumption over this period.

While rental affordability has remained comfortable, caution is deterring landlords from initiating major rental adjustments. Steady, CPI-based adjustments to rentals is the most likely trajectory over the coming year. Further consolidation of fundamentals however over this period will shift the balance of power to owners, facilitating healthier lifts in real rentals. This will ratchet up the pressure on the most vulnerable retailers.

The retail property sector weathered the post-GFC period considerably better than other commercial sectors, with values dropping a modest 12% from peak to trough and yields 'softening' by just over 100bp since 2007. While Sydney retail yields have tightened across most sectors, other capital city retail centres have yet to turn convincingly. Yield re-compression should commence over the next half year. This will be the initial driver of valuation gains as risk aversion gradually subsides, ahead of an income-driven boost to values through 2012.

ANZ's Retail Property Risk Premium is presently sitting well above its long-term average, suggesting persistent investor caution. A reversion to its long-term average, implies a 9% upwards revaluation at today's rental levels. Within the retail sector, there appears greater potential resilience in super and major regional centres (11% higher prices to get to long-term average) with relatively greater vulnerability in the regional and sub-regional. For both these sectors, PRP is presently below long-term averages.⁴

The "fear discount" is expected to subside over the medium-term, as confidence in earnings quality improves and finance supports higher transactions activity. Renewed concerns surrounding the willingness of the consumer to spend, the prospect of higher interest rates and shifting consumer buying patterns pose a challenge for retail property owners. While there is light at the end of the tunnel and good medium-term prospects, conditions warrant a 'tread carefully' strategy over 2011/12.



⁴ The PRP measures the gap between the retail property yield and the real risk-free rate. "fair" value requires measured PRP to equal long-term average PRP.

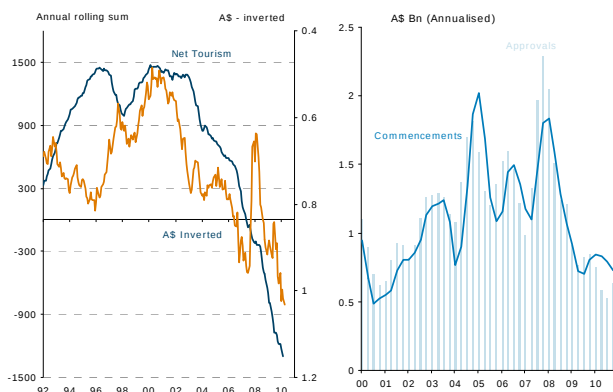
TOURIST ACCOMMODATION

HIGHER A\$ CONTINUING TO WEIGH ON DEMAND

The accommodation sector is operating in a challenging environment, although there has been improvement in its performance over the course of 2010. In trend terms, room occupancy rates nudged up to 64.8% in December from 62.7% the previous year. Higher occupancy rates have underpinned growth in takings, with average room takings climbing by 4.3% over the year to December 2010. The high Australian dollar will continue to weigh on demand conditions in this sector (with Australia now a net exporter of tourists), although limited new supply will help support occupancy rates and average takings.

A record terms of trade, and China's seemingly insatiable demand for commodities, has seen the Australian dollar strengthen, weighing on tourism flows. The stronger Australian dollar, along with discounted international airfares, has resulted in an increasing number of Australians choosing to substitute domestic travel with international destinations. Short term resident departures increased by 12.2% over the year to February 2011, with holiday travel now accounting for 56% of all short term departures, well up on the 41% in 2003. Meanwhile, domestic tourism - as proxied by domestic visitor nights - is forecast to rise by just 3.3% in 2011, with the number of domestic tourist visitor night's remaining 13.5% lower than their 2007 peak.

SUPPLY TIGHTENS AS DEMAND WEIGHS ON MARKET



Although, the international tourism sector is improving, the higher Australian dollar is capping gains. In the wake of the global financial crisis, short term visitor arrivals to Australia fell for eighteen consecutive months. Since then, short term arrivals have steadily recovered to be up 4.8% over the year to February. Healthy economic conditions in Asia, along with Australia's growing ties in the region, have boosted arrivals from Asian countries. Indeed, over the year to February arrivals from China (+29.9%), India (12.8%) and Indonesia (+12.7%) have increased substantially.

Meanwhile tourist arrivals from traditional tourist destinations such as the UK and the US have slid, reflecting sluggish economic conditions in these economies and the weakness of their currencies against the A\$.

The supply side across the accommodation sector remains weak. The number of establishments declined by 0.7% over the year to March, which reflects the tough trading conditions in the sector. Looking ahead, the value of real approvals have continued to decline, falling by 32% over the past year alone. At present, construction activity remains incredibly depressed, with approvals currently sitting at around half of their 10-year average. As such, the sector should continue to benefit from limited new supply, which should support vacancy rates and average room takings.

New South Wales performed particularly well over the course of 2010. Room occupancy rates nudged up to 65% in December from 62% the previous year, which boosted average taking per available room by 7.1%. Tough trading conditions over the previous year saw a contraction on the supply side, with the total number of establishments declining by 1%.

The Queensland market is in the doldrums. Employment in the sector has fallen by an average 2.9% per annum over the past three years and average room occupancy rates have declined from 68% in 2007, to just 62% in December and now sits below the national average. However, a bounce after the natural disaster has stabilised conditions. Growth in average room takings per night increased by only 4.3% over the year to December, making Queensland the second worst performed state behind Tasmania.

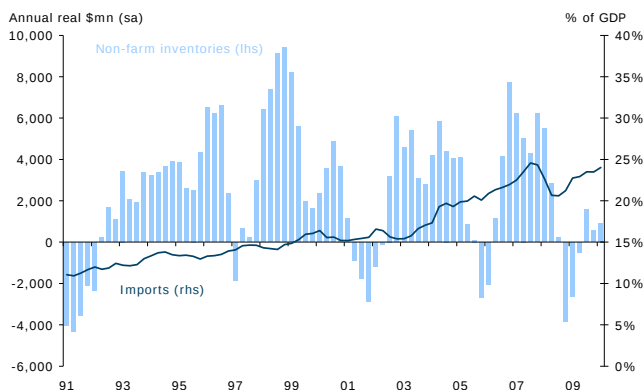
An acceleration in mining related business investment and construction activity in WA is underpinning a recovery in the accommodation sector. Average occupancy rates have increased to 65%, with average takings per available room night increasing by 12% over the year to December. We expect occupancy rates and takings to continue to accelerate over the coming year. Victoria's accommodation sector has been remarkably resilient. Employment in the sector climbed 1.5% y/y to December, and taking per room grew by a healthy 9.7%. Average occupancy rates climbed to 64%, just shy of their peak of 65% in 2007/08.

INDUSTRIAL PROPERTY

MARKET CONDITIONS RIPE FOR INDUSTRIAL PROPERTY

Increased trade activity, fuelled by strong domestic income growth and an Australian dollar at 30-year highs, have spurred demand for industrial space in 2011. Increased imports have driven a rebuilding of inventories, with non-farm inventories around \$900 million higher in the year to December 2010. While slow retail trade and increasing interest rates present headwinds for industrial sectors servicing domestic producers, solid growth in domestic income is expected to drive further growth in imports and a rebuilding in inventories over the next 12-months will support demand for warehouse space.

INVENTORIES BUILDING ONCE AGAIN



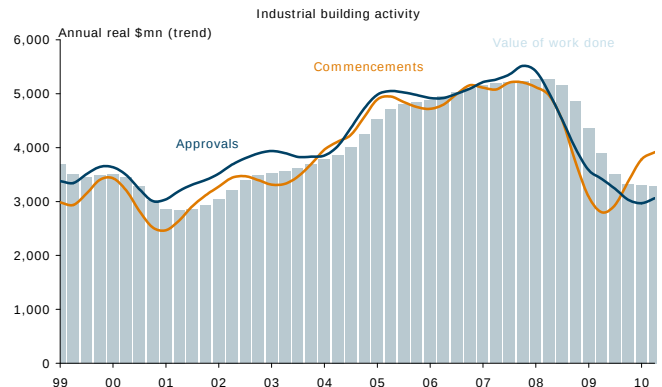
Sources: ABS, ANZ

With increasing demand for industrial space and supply coming off 10-year lows, market conditions are favourable for industrial development. This is already starting to drive speculative development in Melbourne and Sydney and is expected to spill into more broad-based supply expansion through 2011-12.

While the value of completed projects in the year to December 2010 fell to \$3.3bn compared to \$5.3bn in the year to December 2008, industrial building commencements have been increasing in annual trend value terms through 2010, and approvals have "turned the corner" after more than two years of declines.

In addition to the potential for further speculative development, increasing tightness in industrial market conditions will increase take-up of existing vacant space. This market tightness is already putting upward pressure on capital values and rents, particularly for prime grade space.

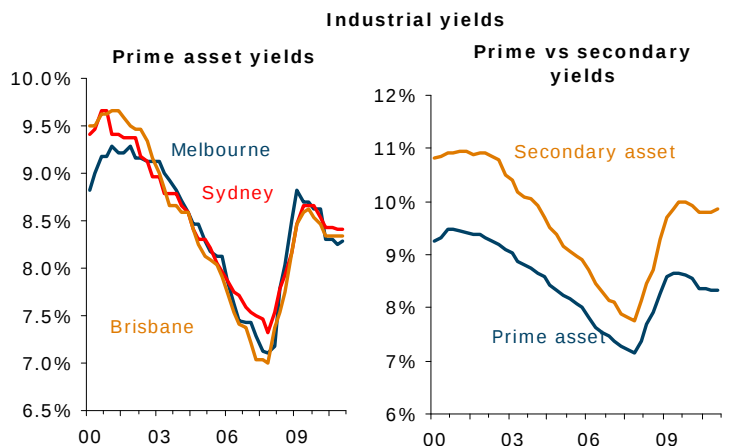
NEW SUPPLY TO EXPAND FROM LOW BASE



Sources: ABS, ANZ

While yield compression softened in the March quarter 2011, compared to a year earlier industrial yields are around 10-20 basis points lower. Since December 2010 prime yields have remained largely unchanged to be 8.25-8.5% while secondary grade asset yields have been softer at around 9.5-10.25%. The current market imbalance has seen the premium on prime asset yields pushed out slightly further to around 150 bps in March quarter 2011 after sitting at around 60 bps in the early part of 2008.

YIELD COMPRESSION TAKES A BREATHER



We anticipate that industrial yields will compress further through 2011 as tight market fundamentals and easing credit availability present favourable conditions for speculative and broad-based expansion in industrial supply. In the short-term, these tight conditions are likely to support the yield premium on prime assets. However, as supply expands and market conditions ease, asset class the premium should deteriorate further.

IMPORTANT NOTICE

Australia and New Zealand Group Limited is represented in:

AUSTRALIA

Australia and New Zealand Banking Group Limited
ABN 11 005 357 522
ANZ Centre Melbourne, Level 9, 833 Collins Street, Docklands
Victoria 3008, Australia
Telephone +61 3 9273 5555 Fax +61 3 9273 5711

UNITED KINGDOM BY:

Australia and New Zealand Banking Group Limited
ABN 11 005 357 522
40 Bank Street, Canary Wharf, London, E14 5EJ, United Kingdom
Telephone +44 20 3229 2121 Fax +44 20 7378 2378

UNITED STATES OF AMERICA

ANZ Securities, Inc. is a member of FINRA (www.finra.org) and registered with the SEC.
277 Park Avenue, 31st Floor, New York, NY 10172,
United States of America
Tel: +1 212 801 9160 Fax: +1 212 801 9163

NEW ZEALAND BY:

ANZ National Bank Limited
Level 7, 1-9 Victoria Street, Wellington, New Zealand
Telephone +64 4 802 2000

This document ("document") is distributed to you in Australia and the United Kingdom by Australia and New Zealand Banking Group Limited ABN 11 005 357 522 ("ANZ") and in New Zealand by ANZ National Bank Limited ("ANZ NZ"). ANZ holds an Australian Financial Services licence no. 234527 and is authorised in the UK and regulated by the Financial Services Authority ("FSA").

This document is being distributed in the United States by ANZ Securities, Inc. ("ANZ S") (an affiliated company of ANZ), which accepts responsibility for its content. Further information on any securities referred to herein may be obtained from ANZ S upon request. Any US person(s) receiving this document and wishing to effect transactions in any securities referred to herein should contact ANZ S, not its affiliates.

This document is being distributed in the United Kingdom by ANZ solely for the information of its eligible counterparties and professional clients (as defined by the FSA). It is not intended for and must not be distributed to any person who would come within the FSA definition of "retail clients". Nothing here excludes or restricts any duty or liability to a customer which ANZ may have under the UK Financial Services and Markets Act 2000 or under the regulatory system as defined in the Rules of the FSA.

This document is issued on the basis that it is only for the information of the particular person to whom it is provided. This document may not be reproduced, distributed or published by any recipient for any purpose. This document does not take into account your personal needs and financial circumstances. Under no circumstances is this document to be used or considered as an offer to sell, or a solicitation of an offer to buy.

In addition, from time to time ANZ, ANZ NZ, ANZ S, their affiliated companies, or their respective associates and employees may have an interest in any financial products (as defined by the Australian Corporations Act 2001), securities or other investments, directly or indirectly the subject of this document (and may receive commissions or other remuneration in relation to the sale of such financial products, securities or other investments), or may perform services for, or solicit business from, any company the subject of this document. If you have been referred to ANZ, ANZ NZ, ANZ S or their affiliated companies by any person, that person may receive a benefit in respect of any transactions effected on your behalf, details of which will be available upon request.

The information herein has been obtained from, and any opinions herein are based upon, sources believed reliable. The views expressed in this document accurately reflect the author's personal views, including those about any and all of the securities and issuers referred to herein. The author however makes no representation as to its accuracy or completeness and the information should not be relied upon as such. All opinions and estimates herein reflect the author's judgement on the date of this document and are subject to change without notice. No part of the author's compensation was, is or will directly or indirectly relate to specific recommendations or views expressed about any securities or issuers in this document. ANZ, ANZ NZ, ANZ S, their affiliated companies, their respective directors, officers, and employees disclaim any responsibility, and shall not be liable, for any loss, damage, claim, liability, proceedings, cost or expense ("Liability") arising directly or indirectly (and whether in tort (including negligence), contract, equity or otherwise) out of or in connection with the contents of and/or any omissions from this communication except where a Liability is made non-excludable by legislation.

Where the recipient of this publication conducts a business, the provisions of the Consumer Guarantees Act 1993 (NZ) shall not apply.