lmi housing outlook

Australian Housing Outlook 2010–2013

Prepared by BIS Shrapnel

October 2010

QBE

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introduction

Welcome to the latest lmiHOUSING OUTLOOK for Australia, exclusively compiled by one of Australia's leading provider of industry research, analysis and forecasting services BIS Shrapnel.

Our forecasts this time last year projected that the low interest rate environment and positive affordability would be the catalysts for the upturn in house prices. The Federal Government's First Home Owner's Grant Boost Scheme (FHOGBS), in addition to record low interest rates and improved economic conditions, assisted house price increases throughout 2009 and early 2010.

We expected this price growth to taper off into 2010 and as we have seen this year, there has been a definite slowing in purchaser demand and residential price growth across the Australian housing market. In response to the vastly improved outlook for the economy, the Reserve Bank of Australia pushed through a number of rate rises between October 2009 and May 2010, taking the average variable rate to 7.4% and having the effect of moderating house price growth.

The expiry of the FHOGBS at the end of 2009 has seen a strong reduction in first home buyer demand in the market during 2010 and with a smaller pool of buyers, demand from potential upgraders has also slowed.

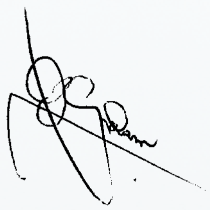
The continued improving economic environment is expected to facilitate house price growth over the next three years. We expect price rises will be underpinned by a deficiency of dwelling stocks across most capital cities, which in turn will lead to tight vacancy rates and solid rental growth, flowing through to increased investor demand.

Although first home buyer activity was pulled forward into 2009 because of the FHOGBS and is now down 50% to 60% on the levels seen at the same time last year, demand is forecast to return to more normal levels, expected to be around 130,000 to 140,000 approved loan applications in 2011.

BIS Shrapnel are expecting total house price growth to range from 9% to 20% across Australia. Those cities where affordability is most constrained or there are fewer pent up demand pressures are likely to experience price growth at the lower end. Those where affordability is not as strained or there is a substantial dwelling deficiency are likely to experience price growth at the higher end.

QBE LMI has been supporting the Australian mortgage market for over 45 years. We continue to be committed to the mortgage industry by giving mortgage lenders the security and confidence to be responsive to the changing needs of borrowers and offer higher Loan to Value ratio loans both now and in the future.

I trust you will find this report informative and its forecasts insightful into what we can expect from the Australian housing market over the next three years.



Ian Graham
CEO, QBE LMI

"The continued improving economic environment is expected to facilitate house price growth over the next three years."

lmi housing outlook

1. executive summary

House price growth gained momentum across most capital cities through calendar 2009, after the price decreases in the second half of 2008. In an effort to stabilise prices at the end of 2008, the Federal Government increased first home buyer incentives with the First Home Owner's Grant Boost Scheme (FHOGBS). At the same time, the standard variable rate was reduced to a 49 year low of 5.8% by April 2009. These factors not only stabilised prices, but with economic conditions not deteriorating as much as first expected, they also helped drive house price growth through 2009.

Initially, the rise in activity was at the more affordable end of the market, underpinned by a surge in first home buyer demand stimulated by the FHOGBS. Upgrader activity also subsequently began to increase during the year with the buoyant demand for entry level properties allowing sellers to trade up to a more expensive dwelling. By the end of 2009, the median house price in all the state and territory capitals had reached new peaks. Investor demand also began to increase, with investors seeking to capitalise on the price growth that was occurring.

There is evidence however that median house price growth has begun to stall in 2010. As the risk of a downturn in the Australian economy faded, the Reserve Bank of Australia (RBA) steadily increased the cash rate by 1.5 percentage points between October 2009 and May 2010, taking the variable rate to 7.4%—closer to the recent long term average. Without the highly stimulatory interest rates of the middle of 2009, affordability has worsened across the board, reducing the potential for further substantial price rises.

In addition, the number of first home buyers in the market has also weakened dramatically. Many first home buyers who would have otherwise entered the market during 2010 brought forward their decision to purchase into 2009 to take advantage of the FHOGBS, leaving a "hole" in demand now. Without healthy demand at the most affordable end of the market, the impetus to upgrade has also decreased and dwelling turnover has weakened. While investor demand is still increasing, slowing price growth means that the rate of increase is also slowing.

As a result, median price growth in the first six months of 2010 has been weaker than that displayed in the second half of 2009. Nevertheless, prices have still continued to rise, albeit at a lower rate. Economic growth has been slowly gaining momentum, and this has been flowing through to employment growth and confidence. At 7.4% in September 2010, the standard variable rate remains conducive to price growth, with affordability in most cities still at a point that coincided with price growth during previous periods when affordability was at a similar level. This should also prevent any negative price growth coming through in 2010/11.

However, price growth in 2010/11 is still expected to remain constrained with turnover still at lower levels on the back of weaker first home buyer demand, which in turn has meant that upgrader demand will be more subdued. The upturn in construction over 2009/10 will also pause, and the new dwelling market shifts a gear from first home buyer to upgrader demand. This will exacerbate the dwelling deficiency in some cities.

“Without healthy demand at the most affordable end of the market, the impetus to upgrade has also decreased and dwelling turnover has weakened.”

1. executive summary (cont.)

Price growth is then expected to be stronger over 2011/12. First home buyer demand should be returning back to long term averages over 2011, underpinning a rise in purchasers trading up, which will also add to new home demand. Economic growth is also forecast to continue to accelerate, fuelling employment and income growth. With only a 25 basis point rise in interest rates forecast over 2010/11, confidence will have improved. This will to some extent overcome further rate rises of 75 basis points forecast over the year, and there should be some momentum in prices appearing in 2011/12.

Price growth is expected to generally peak in 2012/13 as economic growth also peaks. New dwelling construction will be increasing, while investment in the resource sector is also expected to be fully ramped up, promoting strong employment and income growth. However, in this environment, skills shortages will be becoming apparent and wage cost inflationary pressures becoming a concern. Sharper rises in interest rates are expected during the year, although the full rise in the cash rate is not expected to be passed on as improvement in overseas credit markets should increase competition amongst lenders and reduce the margin between the variable rate and the cash rate. As a result, the variable rate is forecast to peak at 9.1%. This will ultimately have a slowing effect on the economy and prices, although there may be one last gasp for price growth in some cities in 2012/13 where there is a large deficiency, or affordability is not as strained.

Price growth is forecast to be strongest over the next three years in **Perth**, **Sydney** and **Adelaide**—all experiencing forecast rises of around 20% in median house prices. Perth and Sydney were already in downturn ahead of the Global Financial Crisis (GFC), and affordability in these cities is better than its previous worst levels, while significant dwelling stock deficiencies are also building up. In Adelaide, there is not a deficiency, but affordability is better than the other main state capitals and there is scope for catch up.

Slightly more moderate price growth is expected in **Brisbane** (+15%), where the upturn is expected to lag, based on the current weaker local economic conditions and the timing of the commencement of the next round of big investment in the resource sector. Moderate price growth is also expected in **Hobart** (+13%), with some excess supply possible emerging and offsetting its affordability advantage.

The weakest price growth is expected in **Darwin** (+12%), where affordability is at its worst level on record and economic growth is likely to slow upon the completion of large resource expansions, in **Canberra** (+10%), where tighter Federal Government spending should impact on demand, and **Melbourne** (+9%), where affordability has also become strained after significant price rises in 2009/10.

Table 1: Median house prices by capital city
Source: Real Estate Institute of Australia, BIS Shrapnel

Quarter ended June	Sydney		Melbourne		Brisbane		Adelaide		Perth		Hobart		Canberra		Darwin	
	$'000	% Var	$'000	% Var	$'000	% Var	$'000	% Var	$'000	% Var	$'000	% Var	$'000	% Var	$'000	% Var
1996	220.0	3.3	155.0	3.3	130.0	0.0	111.5	-1.1	127.0	-0.8	112.0	6.7	158.0	3.9	168.0	-6.7
1997	241.0	9.5	179.0	15.5	134.0	3.1	114.9	3.0	135.0	6.3	105.0	-6.3	155.0	-1.9	178.0	6.0
1998	272.0	12.9	208.0	16.2	139.0	3.7	120.3	4.7	143.3	6.1	107.0	1.9	160.0	3.2	180.0	1.1
1999	296.0	8.8	232.0	11.5	145.0	4.3	125.0	3.9	148.5	3.6	115.0	7.5	158.0	-1.3	176.0	-2.2
2000	337.0	13.9	264.0	13.8	155.0	6.9	135.0	8.0	157.8	6.3	130.0	13.0	184.0	16.5	190.4	8.2
2001	364.0	8.0	302.0	14.4	160.0	3.2	148.4	9.9	165.7	5.0	120.3	-7.5	203.0	10.3	187.0	-1.8
2002	452.0	24.2	330.5	9.4	185.0	15.6	170.0	14.6	185.7	12.1	130.0	8.1	227.6	12.1	200.0	7.0
2003	519.0	14.8	355.0	7.4	235.0	27.0	220.0	29.4	210.2	13.2	180.0	38.5	320.0	40.6	206.0	3.0
2004	552.0	6.4	365.0	2.8	307.3	30.7	250.0	13.6	255.0	21.3	252.0	40.0	372.4	16.4	255.0	23.8
2005	528.0	-4.3	360.0	-1.4	315.0	2.5	275.0	10.0	295.0	15.7	260.0	3.2	352.5	-5.3	279.8	9.7
2006	526.8	-0.2	371.1	3.1	326.0	3.5	287.0	4.4	400.0	35.6	277.0	6.5	380.1	7.8	350.0	25.1
2007	532.6	1.1	415.0	11.8	366.3	12.4	312.8	9.0	455.0	13.8	310.0	11.9	426.5	12.2	395.0	12.9
2008	546.0	2.5	450.0	8.4	420.0	14.7	370.0	18.3	445.0	-2.2	325.0	4.8	467.5	9.6	423.3	7.2
2009	551.2	1.0	442.0	-1.8	419.0	-0.2	360.0	-2.7	450.0	1.1	336.0	3.4	450.0	-3.7	469.9	11.0
2010	624.0	13.2	559.0	26.5	460.0	9.8	410.0	13.9	490.0	8.9	366.5	9.1	525.0	16.7	555.0	18.1
2011*	650.0	4.2	575.0	2.9	475.0	3.3	435.0	6.1	505.0	3.1	380.0	3.7	540.0	2.9	570.0	2.7
2012*	690.0	6.2	595.0	3.5	500.0	5.3	470.0	8.0	545.0	7.9	400.0	5.3	560.0	3.7	595.0	4.4
2013*	750.0	8.7	610.0	2.5	530.0	6.0	490.0	4.3	590.0	8.3	415.0	3.8	580.0	3.6	620.0	4.2
Total Forecast Growth (%)																
2010-2013		**20.2**		**9.1**		**15.2**		**19.5**		**20.4**		**13.2**		**10.5**		**11.7**

* BIS Shrapnel forecasts

2. economic outlook

State of play

The June quarter 2010 Gross Domestic Product (GDP) result surprised on the upside, with activity rising a healthy 1.2% over March quarter 2010. This result brings growth for the 2009/10 financial year to 2.3%, a much improved result on the 1.2% seen throughout 2008/09. The latest national accounts data is further evidence that the economy is well into a sustained recovery, with private sector activity taking up the slack from waning public sector growth impetus.

The direction of consumer confidence will largely decide the near term strength of the economy. Consumer spending surged 1.6% in June quarter 2010, its strongest quarter-on-quarter result since the June quarter of 2007. The National Accounts data published by the Australian Bureau of Statistics (ABS) indicated that exports of minerals and metals also played an important role in the economy's strong quarterly GDP with net exports contributing 0.4% to the 1.2% growth. In fact, had mining production been able to keep pace with demand, the growth result would have been even more impressive.

Otherwise, total investment showed only modest growth in June quarter 2010, entirely underpinned by strengthening in housing construction—both public and private. The impetus to growth from stimulus measures has already peaked, but work on existing projects will preclude a sharp downturn in 2010/11.

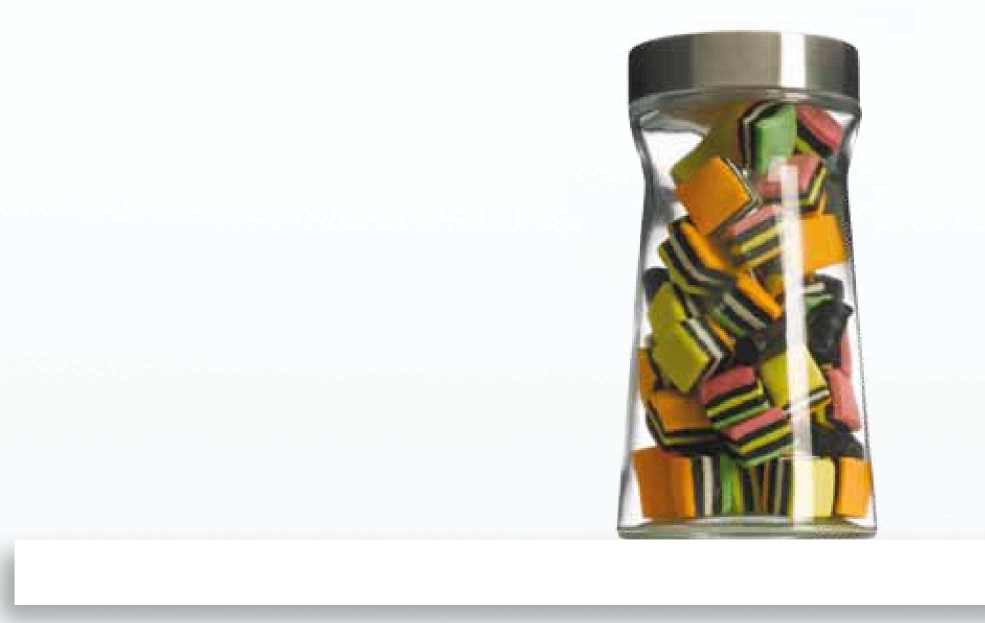
In particular, the health, building and road construction programmes will initially offset the impact of the winding down in education projects. However, public sector investment is expected to weaken over 2010/11, before falling away sharply over 2011/12 as the stimulus projects finish up. Following a significant deterioration in public finances as a result of the GFC, economic downturn and stimulus measures, policy debate has recently centred on how to cut back public sector spending. However, public consumption expenditure is now carrying significant momentum in 2010/11 and any attempts at cutbacks are unlikely to be felt before 2011/12.

Overall, it appears that investment and in particular construction, will not be a major growth driver through 2010/11. Dwelling investment experienced a strong quarter of growth in June 2010 as the pull-forward of demand from the FHOGBS finally translated into a major increase in construction. However, approvals following the expiry of the FHOGBS at the end of 2009 resulted in much weaker growth and the contribution to growth from dwelling investment in 2010/11 is likely to be comparatively modest. The recovery is still expected to continue to gain momentum, underpinned by strengthening incomes, strong pent-up demand, an easing in finance constraints for developers and a buoyant rental market.

“Based on a continued recovery in the world economy, demand for our commodities is set to remain strong in the near term.”

The outlook for the world economy remains a concern. In the United States the housing sector continues to languish and the employment recovery is elusive. In Europe the focus remains on slashing debt and putting economies back on a sustainable growth path. China continues to battle the inflation resulting from its credit boom. China’s growth has slowed in response to higher interest rates and capital requirements at banks. Meanwhile impetus from stimulus measures around the world has peaked and will be increasingly wound back over 2011. Downside risks to growth have mounted through 2010, but on balance the United States should avoid a double-dip recession and the Chinese authorities will continue to support growth in their economy.

Based on a continued recovery in the world economy, demand for our commodities is set to remain strong in the near term. Export growth and particularly export incomes are set to be a major contributor to GDP over 2010/11. The surge in the terms of trade will stoke national incomes, but the initial flow-on impact to activity and prices is not set to be pronounced. The June quarter 2010 inflation result was surprisingly benign and demand pressures are not expected to be a major problem through 2010/11.



2. economic outlook (cont.)

Table 2: Key economic indicators
Source: Australian Bureau of Statistics, BIS Shrapnel

Year Ended June	2006	2007	2008	2009	2010	2011*	2012*	2013*
Expenditure on GDP (at average 2007/08 prices)								
Consumption								
Private Consumption	2.8	4.2	4.1	0.9	2.7	3.5	4.3	3.9
Government Consumption	2.5	3.7	3.2	2.8	4.6	4.1	2.9	2.2
Private Investment								
Dwellings	-4.3	1.9	1.3	-1.9	1.7	5.0	10.4	8.6
Real Estate Transfer Expenditure	2.4	-0.9	0.2	-15.6	11.1	7.6	8.1	-9.5
New Non-Dwelling Construction	20.1	12.1	9.4	8.5	-6.5	-0.5	5.9	10.5
New Equipment	15.3	3.0	19.5	0.3	-3.1	8.5	11.5	15.5
New Business Investment (+)	15.7	7.8	14.3	4.6	-2.8	5.0	8.9	13.5
New Public Investment	7.9	4.9	9.6	10.2	26.6	0.2	-10.4	-4.4
Gross National Expenditure (GNE)	**4.1**	**4.8**	**5.8**	**0.9**	**3.9**	**4.0**	**4.3**	**4.9**
GDP (Average)	**3.1**	**3.8**	**3.7**	**1.2**	**2.3**	**3.8**	**4.1**	**3.9**
Inflation & wages (Jun on Jun)								
CPI	4.0	2.1	4.5	1.5	3.1	2.9	3.1	3.5
Baseline	2.5	2.7	3.6	3.6	2.8	3.0	3.0	3.5
Average Weekly Earnings (Yr. Ave.)	3.2	5.0	4.0	6.1	5.2	4.0	4.6	5.0
Employment (%)								
Employment Growth (August on August)	2.5	3.0	2.8	0.2	3.0	2.1	2.7	2.8
Unemployment Rate (August)	4.8	4.3	4.3	5.8	5.1	5.0	4.3	3.8
Interest Rates (% at 30 June)								
Cash rate	5.75	6.25	7.25	3.00	4.50	4.75	5.50	6.50
Housing (variable)	7.55	8.05	9.45	5.80	7.40	7.65	8.30	9.10

* BIS Shrapnel forecasts

Nevertheless, the strength of employment growth and the lack of slack in labour markets is a concern for the RBA. Consumers held back through 2009/10, still wary of the sustainability of the recovery and paying down debt after the GFC. However, they have now built up a significant savings buffer. With incomes recovering, they are in the position to begin both spending and borrowing once more. Confidence has rebounded, but this has only just started to translate into higher spending. Moreover, large parts of the retail sector are still reporting soft trading conditions.

Growth in consumer spending in the September quarter 2010 is expected to be weaker than that in the June quarter 2010, which appeared to be a rebound boosted by discounting. However, there is likely to be considerable pent-up demand for spending, which we have already seen for motor vehicles, which suggests that consumers will further loosen their purse strings. This is good news for retailers, but it could impact on the speed at which the RBA resumes its interest rate tightening phase. The RBA has kept interest rates on hold since May 2010 given the build up in external headwinds and weak lending and retail data, but this could quickly change if consumer spending gained sufficient momentum.

The real threat to growth will come over 2011/12 and 2012/13 when private investment activity starts to crank up and labour market shortages and capacity constraints in infrastructure resurface. The downside of a recovery from a position of little slack in labour and product markets is that the economy will struggle to cope with a synchronised upswing in investment sectors, even if public sector activity is no longer pro-cyclical. We expect the RBA to respond aggressively to the emergence of demand inflationary pressure.

The Federal election in August 2010 saw the Labor Party returned as a minority government—gaining the support of selected independent candidates and the Greens representative. The result is unlikely to have a large impact on conditions going forward. Key Labor policies such as the proposed Resource Super Profits Tax and an Emissions Trading Scheme were watered down prior to the campaign and are unlikely to significantly impact on investment going forward. The tie-in with the Greens (and their upcoming majority in the senate) may revive the prospect of a price on carbon in the nearer term, although its impact would depend upon the timing and type of scheme finally decided upon.

State elections were held in South Australia in September 2010, while elections are imminent in Victoria and New South Wales. The Labor Party was returned in South Australia, and is expected to be returned in Victoria, and the outlook is consequently likely to maintain the status quo. Similarly, while a change of government is expected in New South Wales, there is little in the way of policy differences that are likely to impact on the economic outlook going forward—apart from a likely boost to confidence that would come with a change of government.

Interest rates

The official cash rate was reduced to a low of 3% by April 2009 as the economic outlook deteriorated in response to the GFC (Chart 1). However, movements in variable housing rates did not entirely follow the rate reduction prescribed by the RBA. Increased average borrowing costs by the banks were undermining the margins made by banks in home lending, who reacted by supporting their variable and fixed mortgage rates to protect profit margins.

The gap between the variable housing rate and the cash rate has increased as a result of the rise in funding costs. Over the decade to June 2007, the standard variable housing rate averaged at 1.8% above the cash rate. This difference has now widened to about 2.9%.

2. economic outlook (cont.)

The cuts to interest rates and Federal Government stimulus spending helped to cushion the negative effects of the GFC on the Australian economy. As a result, the downturn was not as severe as expected, and an upturn is now underway. GDP growth was positive through 2009, and unemployment peaked at 5.8%—well below most estimates of a peak of around 8%. In response, the RBA began the process of raising rates in October 2009 from their highly stimulatory levels, to a level considered to be more commensurate with current economic growth rates. Successive rate rises through to May 2010 has taken the cash rate to the current rate at September 2010 of 4.5%, and the variable rate to 7.4%.

After recording its first post GFC growth in the December quarter 2009, wages and salaries again rose by 2.2% in June quarter 2010 following a 1.8% rise in the first three months of the year. Through-the-year to June quarter 2010, the total wages bill was up around 5% (Table 2). The latest wages data published by the ABS is consistent with the developments in the labour market. The Australian labour market gained some 46,000 additional jobs in June 2010 and a further 23,000 jobs were added in July 2010. In addition, the unemployment rate stood at 5.1% nationally in August 2010 while the job vacancies were at high levels.

The RBA is likely to be wary about the impact that further employment growth will have on wages growth and inflation in the future. However, inflation is not yet a major concern. While the CPI is at the upper end of the RBA preferred range of 2%–3%, the components of the CPI which are either temporarily elevated or have persistently exceeded 3% are those which are largely insensitive to interest rates—this includes housing rents, utilities, health, and education.

As a result, it is expected that the RBA is likely to continue to maintain interest rates at current levels. While there is evidence that the economy is accelerating, wage cost inflationary pressures are unlikely until the unemployment rate falls below 5%. Although the latest published rate of 5.1% at August 2010 is close to this level, it appears that this figure contains some slack, and hours worked will increase before the unemployment rate falls further. On this basis, the unemployment rate is expected to hover around this level and not move below 5% until closer to the end of 2011.

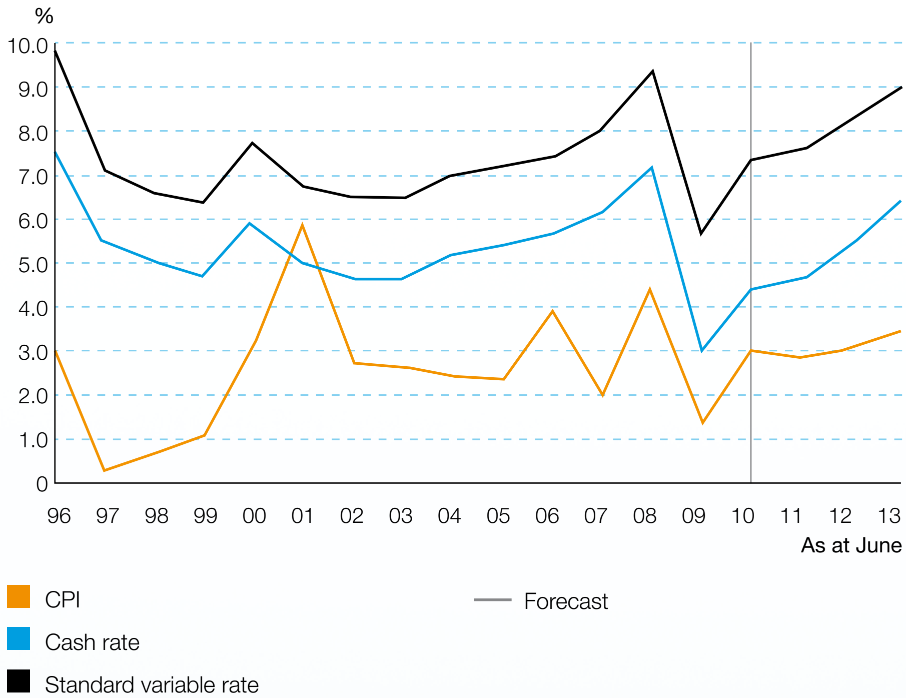
Consequently, interest rates are forecast to remain relatively stable, with the RBA expected to only initially "fine tune" rates as the upturn comes through. At this stage, inflation should remain within the 2%–3% range in the short term, while consumer spending has not shown signs of accelerating, possibly due to concerns about whether the continued weakness in the United States and Europe will eventually flow through to Australia. As a result, the cash rate is expected to remain steady for the remainder of 2010, before being raised by 25 basis points in the first half of 2010. Rates are forecast to then be slowly ratcheted up as economic conditions accelerate in line with the upturn in residential construction, and the ramping up of investment in the resource sector. Nevertheless, inflation is starting from a higher base than at the start of previous upturns, and the RBA has signalled that it could be more pre-emptive with rises in the cash rate. This could push through more interest rate rises earlier.

Rises totalling 75 basis points in 2011/12 and 100 basis points in 2012/13 are forecast to come through as unemployment tightens and capacity constraints emerge in the economy, igniting wage cost inflationary pressures. At some point, it is possible that the higher risk premiums that have been factored into the international cost of debt will diminish. In this event, there will be scope for greater competition to develop in the provision of housing loans, as non–bank lenders will be able to offer competitive rates again. On this basis, margins are forecast to drop back to 2.6%.

Overall, the cash rate is anticipated to rise from 4.5% at June 2010 to 4.75% at June 2011, before increasing further to 5.5% at June 2012 and 6.5% by June 2013. The variable housing rate is expected to rise from 7.4% at June 2010 to 9.1% by June 2013, which assumes that some of the cash rate hike is not passed on by the major banks, as bank margins begin to fall back towards earlier levels.

Chart 1: Interest rates

Source: Australian Bureau of Statistics, Forecasts: BIS Shrapnel



3. housing finance

New lending activity

Chart 2 illustrates the monthly year–on–year percentage change in residential lending to first home buyers, non–first home buyers (i.e. upgraders) and investors. The impact on demand of rising interest rates and the downturn in the economy can be seen in the declines in lending to all sectors in the second half of 2008. The surge in first home buyer demand due to lower interest rates and the FHOGBS is evident through the massive growth in first home buyer activity through calendar 2009.

The upturn in non-first home buyer (upgrader) lending activity lagged the pick up in demand from first home buyers, while the improvement in investor demand was further behind. The surge in first home buyers in the market provided a market for the upgraders to sell to for their next dwelling. As prices stabilised and subsequently began to rise through 2009, investor confidence also improved and demand increased.

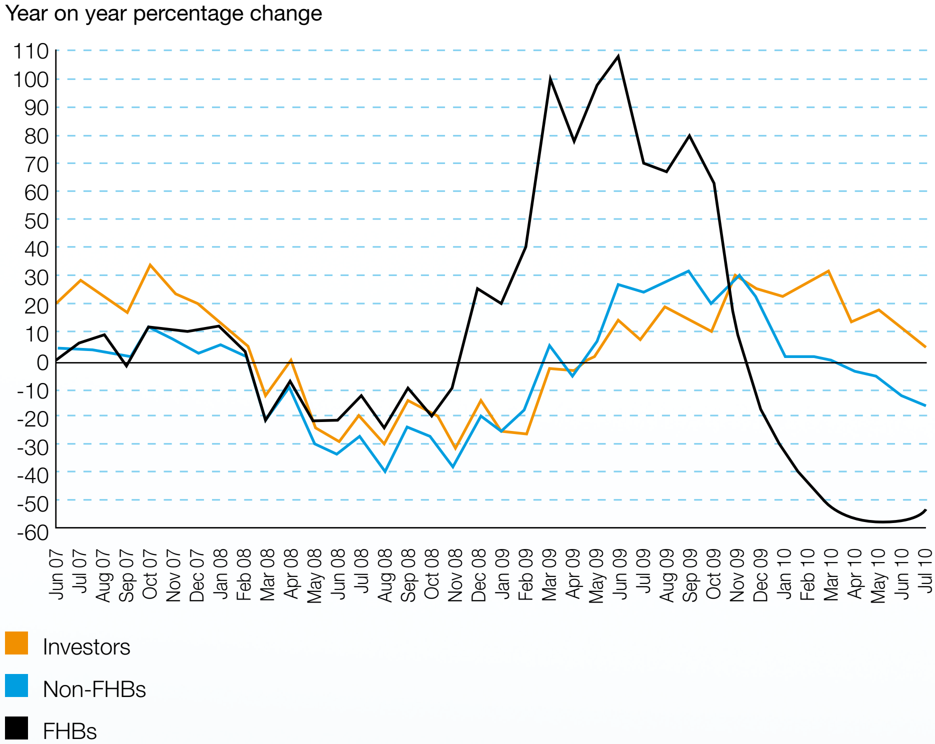
The expiration of the FHOGBS, as well as rises in interest rates over October 2009 to May 2010 has seen first home buyer activity collapse during 2010, as many of the first home buyers who would have otherwise been in the market now had pulled forward their purchase into 2009. Lending to first home buyers in May and June 2010 has been almost 60% down on the same months last year, albeit from what were record levels. The chart suggests that the decline in first home buyer demand has now bottomed out, although there is not likely to be a substantial improvement until 2011.

Without first home buyers to provide support to turnover, non-first home buyer (or upgrader) demand has also been slowly weakening, although the declines have been more moderate. Upgrader demand was expected to have been self-sustaining in 2010 once the FHOGBS expired, however, the upward movement in interest rates in early 2010 is likely to have made upgraders more wary. This was reflected with the initial decline in first home buyer numbers towards the end of 2009 when interest rates were lower, and which had little impact on upgrader demand. However, with the number of non-first home buyers being two to three times larger than the number of first home buyers, this moderation in upgrader demand is becoming evident in most markets in the second half of 2010. Some growth in non-first home buyer demand should begin to return through 2010 as first home buyer demand also starts showing signs of an increase.

Investor demand also began to strengthen through 2009, showing a rising rate of year-on-year growth. With price growth having returned after the market bottomed out at the start of 2009, investor confidence slowly picked up as the economic outlook became more positive. The rate of increase has been slowing since March 2010, although still remains slightly positive, indicating that finance for investment is still growing. This may be due to some increased uncertainty in the international economic environment that was emerging and its potential impact locally. However, given the positive data that has continued to come out for Australia, as well as some volatility in other forms of investment, such as equities, investor demand is expected to continue to still show positive growth overall in 2010/11.

“The surge in first home buyer demand due to lower interest rates and the FHOGBS is evident through the massive growth in first home buyer activity through calendar 2009.”

Chart 2: Annual growth in home loans
Source: Australian Bureau of Statistics



3. housing finance (cont.)

Loans to first home buyers

Table 3 indicates that the decline in loans to first home buyers has generally been consistent across the board, with most states recording a 50%-60% fall in June quarter 2010, compared to the same period last year. Lending to first home buyers in Victoria (–46%) has held up a little better in 2010, while in Queensland (–66%), first home buyer activity has been much weaker. The Queensland economy has been hit hardest by the economic downturn and first home buyer demand also did not rebound to the same extent as the other states.

The fewer first home buyers currently in the market reflect those who brought forward their purchase into 2009 in order to take advantage of the FHOGBS before it expired. As highlighted in Chart 2 earlier, it appears that the June quarter 2010 represents a low point in first home buyer activity, and some recovery should be evident from the second half of 2010, although it is not expected to return to the long term average until well into 2011.

Analysis of the first home buyer market in "Prospects for First Home Buyer Demand" produced by BIS Shrapnel for QBE LMI in April 2010, suggests that, without the FHOGBS (and also higher interest rates), first home buyers are now adjusting their purchase preferences, increasingly opting for smaller dwellings, or established dwellings over new dwellings. In addition, strong population growth is coming through in the key 25–34 year old demographic, providing an increasing pool of potential first home buyers. This should partly cushion the fall in first home buyer lending, which is expected to end up around 40% below the record 2009 level in calendar 2010, representing a decline of around 15%–20% from the underlying level of demand.

Table 3: Number of loans approved to first home buyers for owner occupation, and quarterly change in the number of loans
Source: Australian Bureau of Statistics

	Number of loans ('000s)					% change on corresponding period				
State	Ann. Ave. 1999/00 –2005/06	2006/07	2007/08	2008/09	2009/10	Jun-09	Sep-09	Dec-09	Mar-10	Jun-10
N.S.W.	32,942	38,986	38,480	53,780	41,703	106	73	3	-53	-59
VIC	29,144	33,071	34,089	39,544	38,920	72	67	34	-24	-46
QLD	24,440	31,324	27,361	32,754	24,497	118	86	2	-55	-66
S.A.	7,682	8,443	8,309	11,479	9,218	83	70	2	-48	-59
W.A.	15,620	13,789	16,445	20,782	19,287	82	69	40	-35	-59
TAS	2,148	2,073	2,141	3,181	2,277	96	48	-6	-57	-58
N.T.	1,168	1,119	930	1,215	855	56	29	-23	-55	-51
A.C.T.	1,668	1,792	1,394	2,373	2,200	179	124	26	-36	-56
Australia	**114,811**	**130,597**	**129,149**	**165,108**	**138,957**	**94**	**73**	**15**	**-45**	**-57**

3. housing finance (cont.)

Loans to upgraders

Upgraders represent the largest component of residential demand, at around two to three times the size of the first home buyer market, and therefore have the most influence on the market. However, as potential upgraders are already occupying a dwelling, there is less impetus for them to enter the market to move to their next dwelling unless demanded by life stage movement, or encouraged to by capitalising on a strong market for their current dwelling.

Consequently, while there is always an underlying level of upgrader activity taking place, demand from upgraders is greatest when there is strong demand for their current dwelling. Ultimately this needs healthy demand from first home buyers at the entry level to provide demand for their existing dwelling and encourage them to move on.

Upgrader activity has slowed through calendar 2010, lagging the decline in first home buyer demand, with the number of loans to upgraders down by 8% nationally in year-on-year terms during June quarter 2010 (Table 4). The slowdown has been greatest in Northern Territory, Tasmania, Queensland, and South Australia, although activity is generally weaker across all states.

The slowdown in activity is expected to bottom out in the second half of 2010, before picking up again from early 2011. The expected stability in interest rates and the strengthening economic environment should give upgraders the confidence to re-enter the market in larger numbers, while first home buyer activity is also expected to recover, which should provide an improved market for their current dwelling.

Loans for residential investment

Table 5 indicates the annual change in finance for residential investment. High interest rates led to a sharp drop in investor lending during the second half of 2008, with the value of lending to investors falling by 15% in 2008/09. However the interest rate cuts through 2008/09—together with the additional first home buyer incentives and stabilisation of the Australian economic environment—arrested the decline that was occurring in house prices, and growth in investor demand began to re-emerge nationally in June quarter 2009.

Annual growth in finance for residential investment continued to strengthen through to March quarter 2010, with all states (with the exception of Tasmania) experiencing increasing activity in this time. However, growth has begun to slow in June quarter 2010, with lending for residential investment up by a more moderate 14% in year-on-year terms. Victoria remains the standout performer for growth in the value of investment finance (+41%), while Queensland was the only state to experience a year-on-year decline (–5%). It should also be noted that after accounting for price growth, the growth in the number of investors is likely to be more modest.

The slowdown in investor activity is likely to be in response to the rises in interest rates between October 2009 and May 2010 reducing affordability, while the slowing in the rate of price growth is likely to have also resulted in some weakening of sentiment. With interest rates expected to be more stable in 2010/11, and turnover expected to slowly increase again, growth in investor activity is expected to remain positive across most states, although is still expected to be moderate.

Table 4: Change in number of loans approved to upgraders

Source: Australian Bureau of Statistics

	Non-FHBs loans (% change from previous period)			Percentage change on corresponding quarter				
State	2007/08	2008/09	2009/10	Jun-09	Sep-09	Dec-09	Mar-10	Jun-10
N.S.W.	-3	-16	8	7	30	22	-4	-10
VIC	-2	-14	17	8	27	25	10	6
QLD	-5	-22	7	11	33	24	-2	-18
S.A.	-8	-13	-1	12	22	12	-15	-18
W.A.	-18	-23	15	5	18	31	18	-3
TAS	1	-18	1	10	36	17	-18	-24
N.T.	-10	-10	1	11	35	12	-9	-25
A.C.T.	3	-2	9	13	13	21	2	4
Australia	**-6**	**-17**	**10**	**8**	**27**	**23**	**0**	**-8**

Table 5: Change in value of investment loans for the purchase of property for rent/resale

Source: Australian Bureau of Statistics

	% change on corresponding period							
	2007/08	2008/09	2009/10	% change on corresponding previous period				
State	% var	% var	% var	Jun-09	Sep-09	Dec-09	Mar-10	Jun-10
N.S.W.	-5	-7	15	21	17	18	20	7
VIC	26	-9	26	-1	11	18	34	41
QLD	8	-29	12	-11	5	21	31	-5
S.A.	22	-17	21	-3	17	19	23	24
W.A.	-8	-21	19	-2	11	30	31	10
TAS	12	-11	12	-3	34	19	-2	1
N.T.	-9	11	45	36	90	61	36	9
A.C.T.	15	-3	41	27	55	49	56	13
Australia	**5**	**-15**	**18**	**4**	**13**	**21**	**27**	**14**

3. housing finance (cont.)

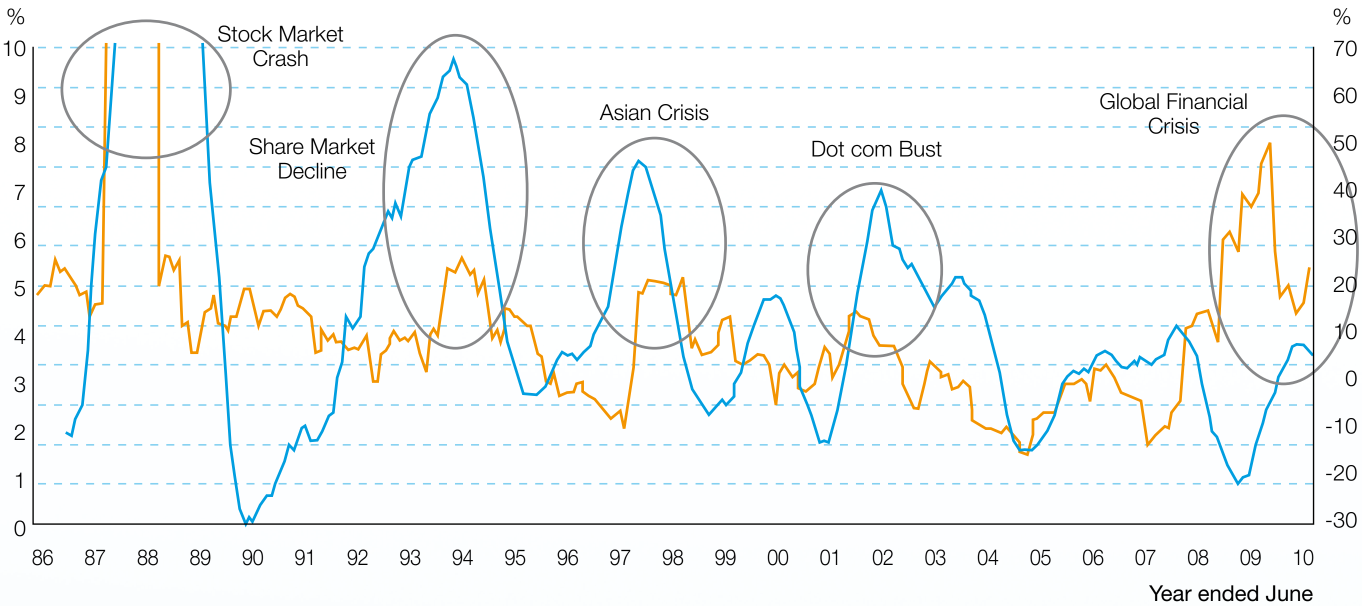
Anecdotal evidence suggests that the recovery in investor demand in 2009/10 has been in response to the volatility in the share market, with the perceived stability of residential property making it a preferred destination for investment funds. Residential investor activity tends to follow residential market conditions, with price growth attracting greater investor demand (and conversely falling prices deterring investors). However, there have been periods when investor demand has corresponded with increased volatility in the share market.

Chart 3 highlights the volatility of the stock market, as measured by the annual standard deviation of monthly change in the S&P ASX 200 Accumulation Index, versus the annual change in monthly moving annual finance for residential investment. The finance for residential investment has been adjusted for residential price growth in this period to better indicate investor numbers.

Periods of increasing investor demand occurred when volatility in the stock market increased after the 1987 stock market crash, in the mid 1990s, during the Asian Crisis in the late 1990s, after the 2001 "dot com" crash, and more recently with the GFC. While investor activity was already increasing just prior to the Asian Crisis, the rise was arguably magnified once the Asian Crisis had an impact. Similarly, the mid 1990s rise in investors demand was likely to have been magnified by the increased volatility in the share market—particularly as the ASX 200 Index was declining in this period. On this basis, we expect to see the current volatility in stock prices to continue to have a positive influence on investor demand going forward.

Chart 3: Stockmarket volatility and residential investor activity

Source: Australian Securities Exchange/Australian Bureau of Statistics/Real Estate Institute of Australia/BIS Shrapnel



Annual standard deviation of monthly change in S&P ASX 200 Accumulation Index (LHS)

Annual change in moving annual finance for residential investment (RHS)

4. rental markets

Vacancy rates and rental growth

The vacancy rate in each city reflects the level of rental oversupply or deficiency. A vacancy rate of 3% in a market is considered balanced, where rents will rise roughly in line with inflation.

Table 6 highlights residential vacancy rates across the capital cities. Since 2004, all of the capital cities experienced tightening vacancy rates with the strong underlying demand (due to record overseas migration) running above new dwelling supply. Indeed, across all capital cities, vacancy rates were below the balanced market rate at June 2008. However, vacancy rates eased slightly across most cities in 2009 and 2010. In part, this was a response to the FHOGBS, which is likely to have taken a number of tenants out of rental and left stock to back fill.

In particular, vacancy rates have increased more significantly in Brisbane (to 3.9% in June 2010), and in Perth (4.3% in June 2010). These capital cities experienced a bigger shock to their economies with the GFC in 2008/09, with the employment uncertainty likely to have delayed new tenants moving into the newly vacated stock. Otherwise, most of the other capital cities are reporting vacancy rates at less than 2% at June 2010, reflecting their current deficiency of dwellings.

With most states continuing to experience a rising deficiency of dwellings after the downturn in construction since 2008, vacancy rates are generally expected to remain tight. They are expected to have now peaked in Perth and Brisbane and should also begin to tighten again. This will continue to drive moderate to solid rental growth across most capitals in the next two to three years.

Rental growth

Table 6 highlights rental growth in relation to vacancy rates. Rental growth is indicated by increases in the rental component of the Consumer Price Index (CPI).

After strong growth in most of the capital cities from 2006 to 2009 on the back of tightening vacancy rates and strong economic conditions, rental growth (with the exception of Sydney and Melbourne) has generally slowed in 2009/10. The easing in vacancy rates is likely to have reduced some of the pressures on rental growth, while the lower interest rates in 2008/09 and most of 2009/10 will have increased cash flow for landlords, and this has reduced the impetus to push through more substantial rate rises.

Nevertheless, with vacancy rates in most cities expected to stay tight, or be tightening, rental growth in the 5%–7% per annum range is likely in the short term, particularly given the strengthening economic outlook underpinning employment and income growth. The rises in prices and higher interest rates over the past year may also keep tenants in rental longer while they accumulate savings to purchase a home.

"Since 2004, all of the capital cities experienced tightening vacancy rates with the strong underlying demand (due to record overseas migration) running above new dwelling supply."

Table 6: Annual rental growth and vacancy rates

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

	Sydney		Melbourne		Brisbane		Adelaide		CPI
As at June	Vacancy rate (%)	Rental growth (%)	Vacancy rate (%)	Rental growth (%)	Vacancy rate (%)	Rental growth (%)	Vacancy rate (%)	Rental growth (%)	Growth (%)
2002	4.6	2.5	3.8	2.6	4.1	2.4	3.6	3.0	2.8
2003	4.4	0.4	3.9	1.7	2.3	3.5	2.8	3.7	2.7
2004	3.6	2.2	3.6	1.6	2.3	4.6	1.9	3.0	2.5
2005	2.5	1.4	2.6	1.5	2.3	4.4	1.8	2.8	2.5
2006	2.1	2.0	1.7	1.5	2.2	6.2	1.6	3.6	4.0
2007	1.4	4.2	1.4	4.1	1.5	6.6	1.3	4.0	2.1
2008	1.1	7.1	1.0	6.2	2.2	9.3	1.5	4.9	4.5
2009	1.3	7.1	1.4	6.1	3.0	8.1	1.4	5.5	1.5
2010	1.3	9.7	1.5	8.2	3.9	5.7	1.1	3.4	3.1
	Perth		**Hobart**		**Canberra**		**Darwin**		**CPI**
As at June	Vacancy rate (%)	Rental growth (%)	Vacancy rate (%)	Rental growth (%)	Vacancy rate (%)	Rental growth (%)	Vacancy rate (%)	Rental growth (%)	Growth (%)
2002	4.5	2.0	2.3	2.4	3.6	5.7	5.0	0.2	2.8
2003	4.5	1.3	2.8	3.1	3.5	4.9	7.1	1.1	2.7
2004	3.3	2.6	2.2	5.0	4.3	7.4	5.5	1.9	2.5
2005	2.5	2.3	2.5	3.3	2.2	3.0	1.9	3.2	2.5
2006	1.9	4.7	2.2	5.1	2.3	2.9	2.4	4.4	4.0
2007	2.1	9.6	2.3	5.5	2.4	5.4	1.2	8.0	2.1
2008	2.8	12.5	2.3	4.3	0.5	7.4	2.0	8.7	4.5
2009	3.5	9.3	2.1	5.3	2.5	6.7	1.8	13.1	1.5
2010	4.3	5.4	2.2	0.0	1.1	4.9	1.3	0.0	3.1

4. rental markets (cont.)

Housing affordability

Chart 4 shows the ratio between the monthly repayments required to service a 30 year loan of 75% of the national median priced house (at the prevailing housing variable rate) in each city, and average disposable household income across their respective states. The affordability ratio reflects the ability of a purchaser to buy a median priced home.

With the exception of Sydney, all capital cities were at their least affordable at June 2008, when variable rates peaked at 9.6%. In response, price growth had begun to stall in the first half of 2008, but weakened significantly in the second half—being compounded by the worsening economic outlook due to the GFC.

However, affordability subsequently improved across the board over 2008/09, as successive cuts to the cash rate took the housing variable rate to a 49 year low of 5.8% at April 2009. As a result, affordability in most capital cities had improved to around 2003 levels, while in Sydney and Melbourne, affordability was at its best level for around a decade.

With the economic outlook also becoming more positive than originally anticipated, this dramatic improvement in affordability precipitated a recovery in prices over 2009/10. Combined with moves by the RBA to move interest rates more commensurate with economic conditions, affordability has again deteriorated.

The measure of affordability in:

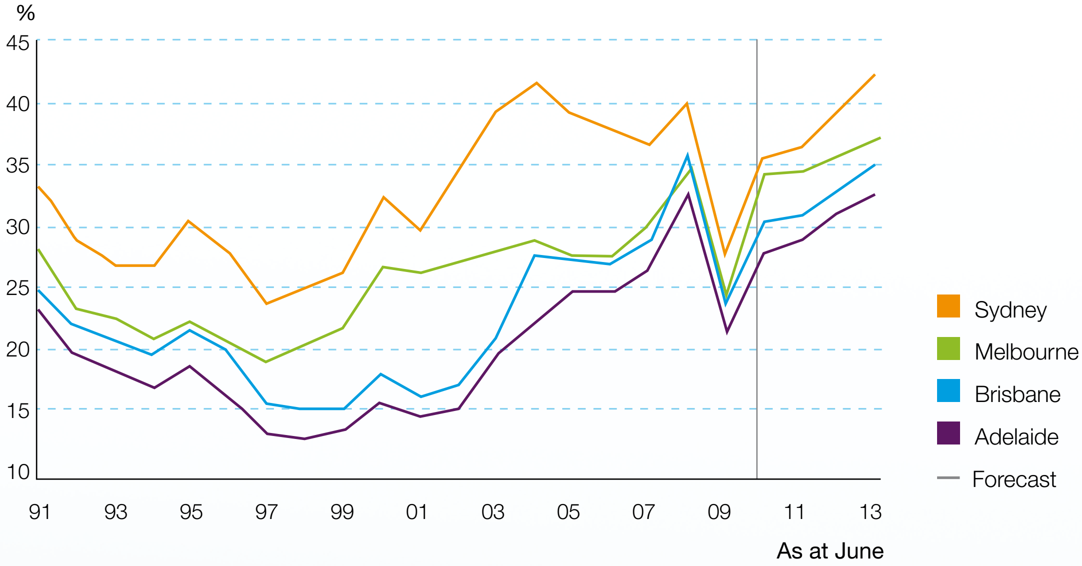
- Melbourne, Brisbane, and Adelaide is somewhere between 2007 and 2008 levels;
- Hobart and Canberra is between 2006 and 2007 levels;
- Perth is between 2005 and 2006 levels;
- Sydney is between 2003 and 2004 levels (when it was already strained); and
- Is at its worst level recorded in Darwin.

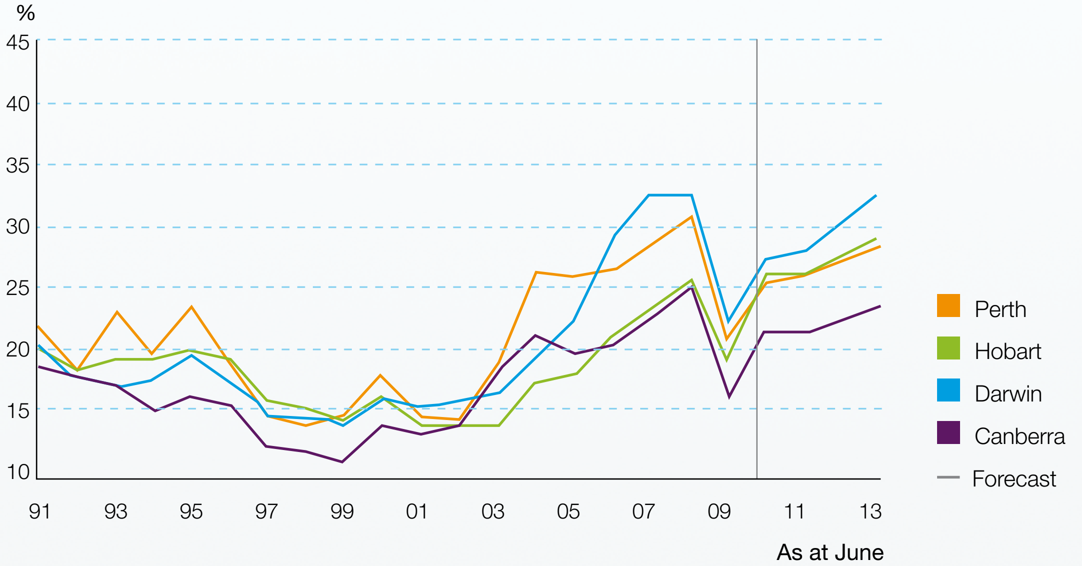
While strengthening economic conditions and the deficiency of dwelling stock in most of the states should provide substantial upward pressure on house prices, the ability for significant price growth to come through will be dampened by this worsening of affordability, particularly given the current upward bias on interest rates. This is reflected by the forecasts of affordability based on forecast price growth moving back to 2008 levels in most cities by the time interest rates reach their forecast peaks in 2013.

Chart 4: Mortgage repayments on a median priced home* as a proportion of monthly disposable household income

Source: Australian Bureau of Statistics, Forecasts: BIS Shrapnel

* Mortgage repayment based on 75% of the median house price





5. demand

Overseas migration

Net overseas migration peaked at a record 298,900 persons in 2008/09. This represents a sharp rise in net overseas migration from 146,800 persons in 2005/06, and was underpinned by strong economic growth and low unemployment, which led the Federal Government to increase its official migrant intake (Table 7). However, a larger share of the growth came from long term overseas visitors, that is, migrants who will come for more than 12 months, although will not necessarily stay permanently. The largest component of this group comprises migrants on student visas, or temporary 457 working visas.

The slower economic conditions saw overseas arrivals peak in March quarter 2009, and numbers are now easing. With student visas and the 457 visas typically lasting up to four years, departures are also beginning to rise as the upturn in overseas arrivals that began in the middle of this decade translates to rising departures. As a result, the net inflow from this group will begin to be reduced (Chart 5).

Overseas arrivals are not expected to show a substantial recovery until some of the excess labour capacity in the economy is absorbed and labour shortages again re-emerge. In this environment, any significant increases to the official Federal Government intake are unlikely to be announced in the short term. With departures of long term residents also rising, this will result in the net inflow continuing to fall to a forecast low of 145,000 persons in 2011/12. While this represents a substantial decline from the 2008/09 record, it remains high in a long term sense, being only moderately lower than the previous record of around 160,000 persons in 1988/89.

“Overseas arrivals are not expected to show a substantial recovery until some of the excess labour capacity in the economy is absorbed and labour shortages again re-emerge.”

Table 7: Net overseas migration (‘000)
Source: Australian Bureau of Statistics, BIS Shrapnel
‘e’: BIS Shrapnel estimate

Year Ended June	N.S.W	VIC	QLD	S.A.	W.A.	TAS	N.T.	A.C.T.	Aust.
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	73.5	62.5	46.3	14.6	31.5	1.4	1.1	2.0	**232.8**
2008	87.2	73.5	54.1	15.3	41.2	1.9	1.6	2.5	**277.3**
2009	89.5	81.2	58.0	17.3	45.2	2.1	1.9	3.7	**298.9**
2010e	69.6	67.2	45.6	15.6	37.0	1.7	1.7	1.7	**240.0**
2011*	47.8	49.0	34.1	11.4	28.9	1.2	1.2	1.4	**175.0**
2012*	39.6	40.6	28.3	9.4	23.9	1.0	1.0	1.2	**145.0**
2013*	41.0	42.0	29.3	9.8	24.8	1.1	1.1	1.2	**150.0**

* BIS Shrapnel forecasts

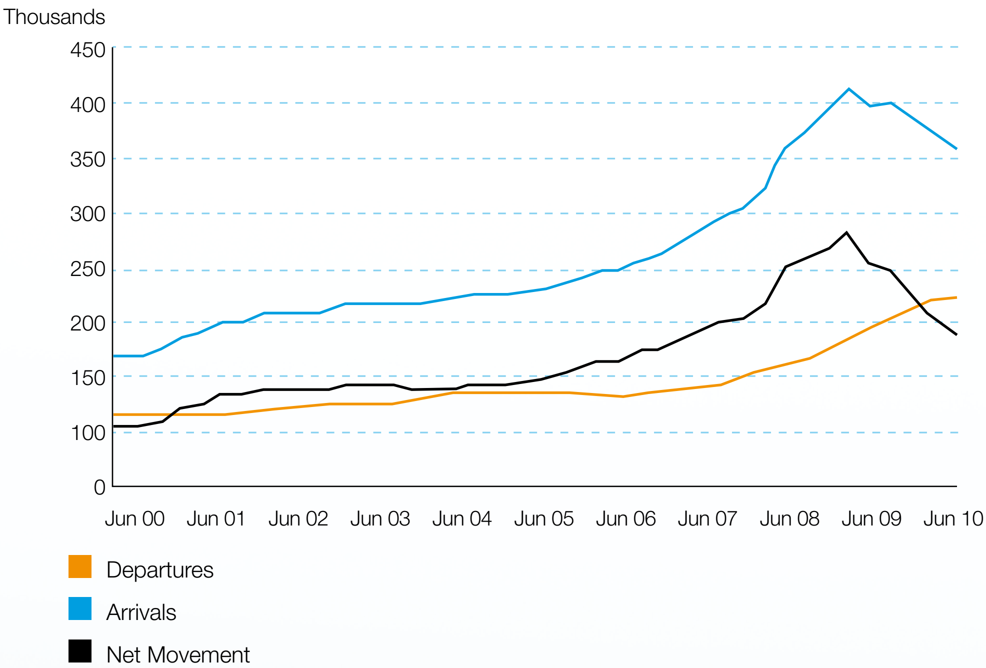
5. demand (cont.)

As economic growth continues to strengthen and unemployment falls below 5%, skills shortages are expected to re-emerge and drive an increase in overseas arrivals on temporary working visas, with the net overseas migration inflow forecast to begin to recover, rising to 150,000 in 2012/13, and peak at over 200,000 persons again in subsequent years.

Australia's forecast overseas migration is expected to average 156,700 persons per annum over the 2010/11 to 2012/13 period. This compares with an average 272,100 persons per annum over the three years to 2009/10, and reflects the more moderate economic environment, as well as rising rate of overseas departures.

Over the next three years, New South Wales is expected to be the initial location for 27% of overseas migrants over the next three years. Other states' expected share of Australia's overseas migration intake in the forecast period is 28% in Victoria, 19.5% in Queensland, 16.5% in Western Australia, and 6.5% in South Australia. The proportion of the total overseas migration inflow is projected to be less than 1% in three years to 2012/13 in Tasmania, the Northern Territory and the Australian Capital Territory. Forecasts for net overseas migration inflows by state are indicated in Table 7.

Chart 5: Long term overseas movement, moving annual totals, Australia
Source: Australian Bureau of Statistics



5. demand (cont.)

Interstate migration

Interstate migration is largely influenced by relative affordability and economic conditions between states. In addition, reduced interstate migration overall generally occurs when economic conditions deteriorate i.e. limited job prospects elsewhere encourage people to stay where they are. More moderate economic conditions currently have subdued interstate migration, with states generally recording reduced flows compared to recent years.

- New South Wales is forecast to average a net outflow of 17,900 persons per annum over the forecast period. This is an improvement from the average of 20,400 persons per annum over the three years to 2009/10, and is well below the peak net outflow of 32,500 persons in 2002/03. The reflects some improvement in the state economic outlook relative to the other states, as well as improved affordability after an extended period of weak prices.
- Victoria is expected to average a net outflow of only 200 persons per annum over the forecast period, similar to the outflow of 300 persons per annum average over the three years to 2009/10.
- Queensland is expected to average a net inflow of 21,300 persons per annum over the forecast period, compared to 18,000 persons per annum over the three years to 2009/10. The net interstate migration inflow is estimated at 12,500 persons in 2009/10, compared to a peak of 38,000 persons in 2002/03. Strong house price growth in Queensland initially caused interstate migration to slow, while the weaker local economic conditions resulted in the sharper contraction over 2008/09 and 2009/10. Nevertheless, the recovery in Queensland's economy, and its climate and lifestyle attractions, should see net interstate migration inflows recover again.
- South Australia is expected to average a net outflow of 3,700 persons per annum over the forecast period. This is down slightly from the 4,200 persons per annum average over the three years to 2009/10.
- Western Australia is expected to average a net inflow of 2,000 persons per annum over the forecast period. This is down from the 3,900 persons per annum average over the three years to 2009/10. Interstate migration will again be rising by 2012/13, as the major resource expansions are fully ramped up and labour markets become very tight.
- The Northern Territory is expected to average a net inflow of 800 persons per annum, similar to the 1,000 persons per annum average which occurred over the previous three years.
- The Australian Capital Territory is expected to average a modest annual net outflow of 200 persons—compared to an inflow of 900 persons over the three years to 2009/10.
- Tasmania is generally expected to experience a balance of interstate arrivals and departures, with a net inflow averaging 200 persons per annum. This is slightly below the average net inflow of 500 persons per annum that was averaged over the three years to June 2010.

“More moderate economic conditions currently have subdued interstate migration, with states generally recording reduced flows compared to recent years.”

Table 8: Net interstate migration (‘000)
Source: Australian Bureau of Statistics, BIS Shrapnel
‘e’: BIS Shrapnel estimate

Year ended June	N.S.W.	VIC	QLD	S.A.	W.A.	TAS	N.T.	A.C.T.
2002	-24.4	4.4	31.2	-1.6	-4.4	-1.5	-2.6	-1.0
2003	-32.5	-0.7	38.0	-1.2	-2.0	2.0	-2.8	-0.8
2004	-31.1	-3.1	35.5	-2.9	2.1	2.6	-1.5	-1.6
2005	-26.3	-3.1	30.4	-3.2	2.2	0.3	0.6	-0.8
2006	-25.6	-1.8	26.6	-2.7	3.9	-0.1	-0.6	0.3
2007	-27.4	-2.4	27.0	-3.7	5.2	-0.9	0.3	1.9
2008	-21.9	-2.7	23.1	-4.5	4.8	0.3	1.2	-0.3
2009	-19.8	0.7	18.4	-4.7	4.8	0.7	0.7	-0.8
2010e	-12.0	1.0	12.5	-3.5	2.0	0.5	1.0	-1.5
2011*	-16.0	1.0	16.0	-4.0	2.0	0.5	1.0	-0.5
2012*	-21.0	0.0	23.0	-4.0	1.0	0.0	0.5	0.5
2013*	-25.0	-1.5	25.0	-3.0	3.0	0.0	1.0	0.5

* BIS Shrapnel forecasts

5. demand (cont.)

Population

National and state population estimates are highlighted in Table 9. Australia's population is projected to grow at an average rate of 1.4% per annum to 23.3 million at June 2013. This will be lower than that recorded over the three years to 2009/10 (1.9% per annum), when a higher net overseas migration inflow was sustained. The more moderate economic environment will mean that overseas arrivals will remain lower until unemployment falls further and labour shortages re-emerge. All the states are expected to record slower growth over the forecast period than over the last four years.

The Northern Territory is expected to record the largest annual growth over the forecast period of 2.2%. Conversely, Tasmania is expected to record the smallest amount of growth, at 0.7% per annum. Western Australia (2.1% per annum) and Queensland (1.9% per annum) are also expected to experience a rate of population growth well above the national average. The common denominator across the three fastest growing states is that they also typically benefit from a net inflow of residents from the other states.

Demand and supply

The underlying demand for new dwellings is driven largely by the formation of additional households, which in turn is largely underpinned by population growth. The balance between underlying demand and supply has an impact on vacancy rates, rents, prices, and construction.

Underlying demand is forecast to average 182,700 new dwellings per annum over the three years to 2012/13—below the estimated underlying demand of 190,500 dwellings in the 2006/07 to 2009/10 period. This is largely due to slower population growth resulting from lower net overseas migration inflows. Nevertheless, in a long term sense, the forecast underlying demand for dwellings in Australia is higher than any point in the 1990s and early part of this decade.

In comparison, new dwelling starts during 2009/10, at 164,800, remain well below the level indicated by the underling demand. As a result, the deficiency of dwellings that is apparent nationally will continue to increase through to June 2012, and will be most concentrated in New South Wales. New dwelling commencements in New South Wales have been weak for a sustained period, and were at a 50 year low in 2008/09. Although a recovery is beginning to emerge, the stock deficiency in New South Wales at June 2010 has risen to a level at around double underlying demand. Although new dwelling activity is expected to continue to increase, they still will be some way off from what is needed to meet demand, and conditions in New South Wales will continue to become tighter.

New dwelling commencements in Queensland are also well under underlying demand, and the state's stock deficiency is also expected to increase rapidly by 2013, as is the deficiency in the Northern Territory. The deficiency in Western Australia is also forecast to rise, although at a more modest rate.

Given the very strong level of new dwelling commencements in Victoria, its existing dwelling deficiency is forecast to have eased somewhat by June 2013, alleviating some of the pressures on construction, prices, and rents. In comparison, South Australia, Tasmania, and the Australian Capital Territory are expected to record an increasing level of dwelling surplus by 2013.

Table 9: Population projections ('000s), 2006 to 2012
Source: Australian Bureau of Statistics, BIS Shrapnel

	N.S.W.	VIC	QLD	S.A.	W.A.	TAS	N.T.	A.C.T.	Aust.
2006	6,816.1	5,126.5	4,090.9	1,567.9	2,059.4	490.0	210.6	334.1	**20,695.5**
2007	6,904.9	5,221.3	4,196.0	1,585.8	2,113.0	493.2	214.8	341.1	**21,070.1**
2008	7,014.9	5,327.0	4,308.6	1,604.0	2,177.0	497.9	220.5	346.3	**21,496.1**
2009	7,134.4	5,443.2	4,425.1	1,623.6	2,245.1	503.3	225.9	352.2	**21,952.8**
2010	7,240.2	5,550.1	4,521.7	1,643.1	2,303.9	508.1	231.7	355.6	**22,354.4**
2013*	7,449.7	5,800.3	4,789.0	1,684.8	2,450.8	519.4	247.0	369.4	**23,310.3**
average annual growth									
2006-2010	1.5	2.0	2.5	1.2	2.8	0.9	2.4	1.6	**1.9**
2010-2013*	1.0	1.5	1.9	0.8	2.1	0.7	2.2	1.3	**1.4**

* BIS Shrapnel forecasts

Table 10: Underlying demand, commencements and stock deficiency, by state
Source: Australian Bureau of Statistics, BIS Shrapnel

	Ave. annual	Dwelling commencements		Deficiency of Stock (est.) ('000)				
State	underlying demand 2010/11 to 2012/13	2009/10 ('000)^	ann. % change	As at Jun-09	As at Jun-10	As at Jun-11*	As at Jun-12*	As at Jun-13*
N.S.W.	46.0	31.5	33.0	74.1	99.3	111.3	118.0	119.2
VIC	48.7	54.1	29.1	36.6	42.2	37.3	33.5	29.5
QLD	43.4	33.2	14.6	26.2	37.7	49.0	56.1	55.8
S.A.	10.8	12.1	1.1	-0.4	-1.2	-2.3	-3.1	-4.4
W.A.	26.8	25.2	36.5	12.2	17.2	20.3	23.3	23.4
TAS	2.3	3.1	7.5	-0.9	-1.0	-1.7	-2.2	-2.7
N.T.	2.0	1.2	8.6	1.9	2.7	3.4	3.8	4.0
A.C.T.	2.7	4.3	62.9	1.3	0.8	-0.7	-1.6	-2.3
Aust.	**182.7**	**164.8**	**25.1**	**151.2**	**197.7**	**216.6**	**227.7**	**222.6**

* BIS Shrapnel estimate based on approvals to June 2010

6. capital city overviews and price forecasts

Sydney

After recording significant price increases in the early 2000s, prices arguably overshot the mark by 2004, and as a consequence, the Sydney residential market experienced a correction in prices. This was exacerbated by steadily rising interest rates from the end of 2003 through to March 2008, and the subsequent downturn in the economy. At its low point in September quarter 2008, the median house price in real terms had fallen by a total of 20% from its peak in March 2004.

Nevertheless, price growth began to recover through calendar 2009 due to the coupled effects of a sharp reduction in interest rates in 2008/09—with the cash rate falling by 4.25 percentage points and the variable rate by 3.8 percentage points between September 2008 and April 2009—and the expanded Federal Government first home buyer incentives. This assistance acted as the catalyst for the median house price to rise by 11% over the twelve months to December 2009.

Over this period, the stimulus to first home buyer activity was concentrated in outer Sydney suburbs, where prices were more conducive to their budgets. This demand was also assisted by further first home buyer incentives offered by developers, and was reflected in Real Estate Institute of Australia (REIA) data showing a 31% rise in the median house price over the twelve months to December 2009. In comparison, the median in middle Sydney suburbs increased by 23% and in inner Sydney suburbs by 19%—possibly reflecting that these areas had shown better price performance over the previous downturn and were starting from a higher price base.

With the Australian economy performing better than expected over the second half of 2009, the RBA raised the cash rate by 150 basis points between October 2009 and May 2010 to 4.5%, placing some pressure on affordability. In addition, the removal of the FHOGBS at the start of 2010 also contributed to the median price in middle and outer Sydney suburbs over the March quarter 2010 to fall by 1.7% and 0.3% respectively. This is in comparison to the robust 19% growth recorded in the more affluent inner Sydney suburbs (REIA). Generally stable prices in June quarter 2010 resulted in the Sydney median house price rising to $624,000 by June 2010, representing an annual rise of 13%.

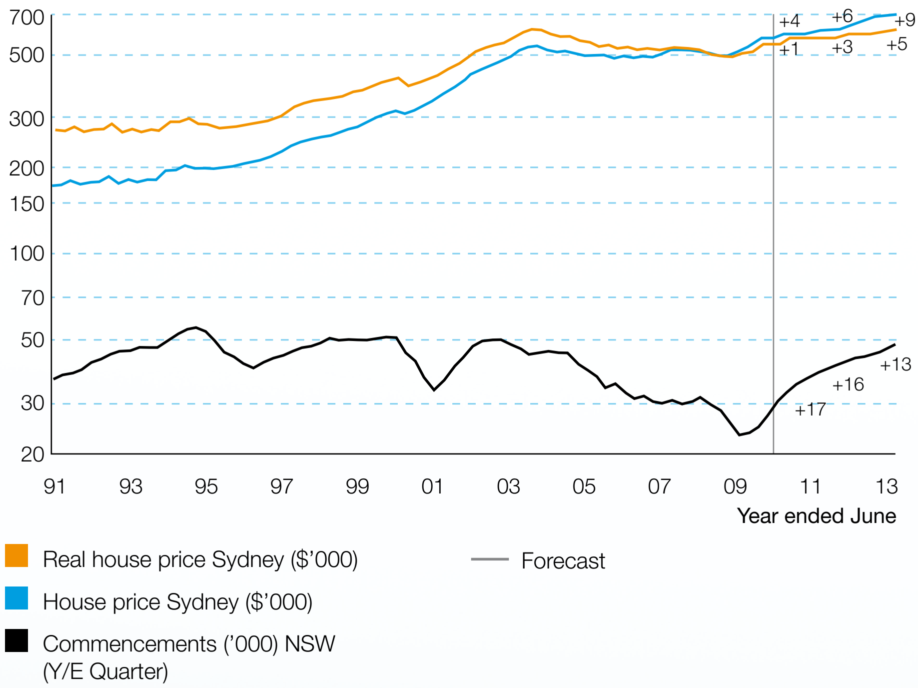
With new dwelling construction in Sydney having fallen to 50 year lows in 2008/09, a massive underlying deficiency of dwellings is in place, and is reflected in Sydney's very low interest rates. This will place upward pressure on prices. However, in the short term, turnover has eased as first home buyer numbers have fallen due to the expiry of the FHOGBS. Nevertheless, higher levels of activity are expected to resume through 2011, as first home buyer demand returns back to its long term level. Together with rising confidence from strengthening economic growth, prices are forecast to subsequently accelerate.

After a forecast rise in Sydney's median house price of 4% in 2010/11, the rate of price growth is projected to pick up to a forecast 6% in 2011/12 as economic growth continues to strengthen. However, during this period, the upturn in economic conditions is expected to slowly begin to push through wage and inflationary pressures, and result in the RBA lifting the official cash rate by 75 basis points through 2011/12 and taking the housing rate to 8.3% by June 2012. While high in a recent sense, in a strong economy, this is not expected to undermine price growth in Sydney, where the underlying dwelling deficiency is at over two years' supply, and a further rise in the median house price of 9% is expected in 2012/13.

However, further rises to interest rates forecast in 2012/13 will take the variable rate to a peak of 9.1%, and this will ultimately create affordability issues by the end of the forecast period. Overall, Sydney's median house price is expected to increase over the three years to June 2013 to $750,000, representing total growth of 20%, or an average of 6.3% per annum. While this represents a high number at face value, in real terms Sydney's median house price will only be on par with the March quarter 2004 peak.

Chart 6: Sydney dwellings, prices and activity

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



6. capital city overviews and price forecasts

Melbourne

Chart 7 highlights that Melbourne's median house price fell to a low of $405,000 in March quarter 2009 due to weak purchaser confidence, which was initially driven by poor affordability and then augmented by the downturn in economic conditions that emerged from the GFC. This median value was a sizeable 14% below the previous peak in house prices of $472,300 in December quarter 2007.

However, sentiment rapidly transformed on the back of improved affordability resulting from a steep reduction in variable interest rates to a 40 year low of 5.8% by April 2009. The first home buyer segment was buoyant in the early stages of the upturn, primarily due to the FHOGBS, with a record 13,136 loans approved to first home buyers in June quarter 2009 alone—a 76% increase on the corresponding quarter the previous year. This underpinned greater sales activity at the affordable end of the market, which later flowed through to higher price points as owners traded up. While the median house price in outer Melbourne increased by 6% from March to June quarter 2009, the overall Melbourne median rose by a greater 9%. Despite this increase, the Melbourne median house price at June 2009 of $442,000 still represented an annual decline of 2%.

The first home buyer market remained robust in the six months to December 2009, as additional State Government incentives magnified the FHOGBS. With the first home buyers providing greater demand for entry level dwellings, this provided a buoyant market for upgraders to sell their existing home to. Consequently, as economic conditions and employment security improved over the second half of 2009, so too did upgrader demand, translating to a stronger rebound in values at the middle and upper end of the market. From the low point in March 2009, the median house price rose by a significant 32% to $535,000 in December quarter 2009, while the upper quartile (top 25%) house price rose by 34%.

Activity has been more subdued in the first six months of 2010. The considerable price growth in 2009 and the 1.6 percentage point rise in variable rates between October 2009 and April 2010 has seen affordability deteriorate to 2008 levels, when interest rates last peaked. The expiry of the FHOGBS at the end of 2009 has also reduced activity at the affordable end of the market, reducing some of the impetus for upgrader activity.

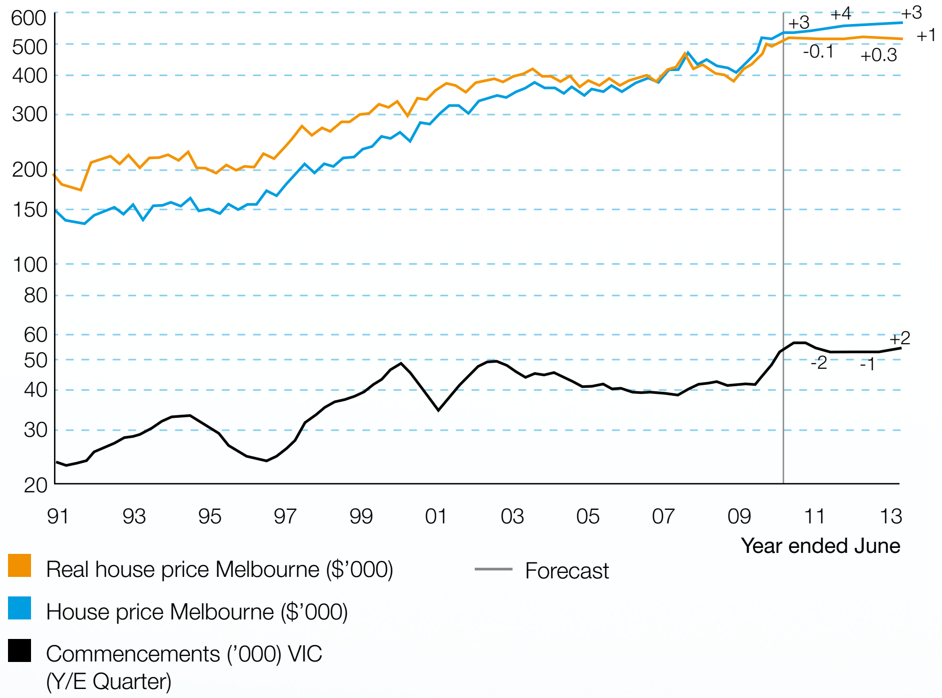
As a result, the median house price increased by only 4.5% in the first half of 2010. Nevertheless, the median value of $559,000 in June quarter 2010 is still a rise of 27% for the year. The more affordable end of the market has been the better performer in the first six months of 2010, with the outer Melbourne median rising by 9%, compared to 6% for inner Melbourne suburbs, and 4% for middle Melbourne suburbs (REIA). This suggests that some of the affordability pressures from the rise in interest rates in this period have pushed demand out to the lower priced outer suburbs.

The scope for further significant house price growth in Melbourne is expected to be limited over the next three years to 2012/13, given the already constrained affordability. The current historical high construction activity in Melbourne's residential market—at above underlying demand—should also alleviate some of the upward pressure on house prices as the deficiency of dwellings is slowly eroded. Moreover, house price growth will be further suppressed by worsening affordability conditions after rises in housing rates over the forecast period taking the variable rate above 9% by 2013.

Reflecting the strong growth in 2009/10, the median house price in Melbourne is forecast to experience the smallest increase amongst the capitals over the three years to 2012/13, at a moderate average compound rate of 3% per annum, with similar annual percentage rises in each year. This would lift the median value to $610,000 by June 2013. However, in real terms, the median house price is actually estimated to decline by less than 1% in total from 2009/10 to 2012/13.

Chart 7: Melbourne dwellings, prices and activity

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



6. capital city overviews and price forecasts (cont.)

Brisbane

Over the two years to 2007/08, Brisbane's median house price jumped by 29% to a peak of $420,000 at June 2008 (Chart 8). Significantly, affordability had become strained, and Brisbane became less affordable than Melbourne and the second least affordable capital city nationally after Sydney.

Rising interest rates which peaked at 9.6% in July 2008 began to take their toll, with prices weakening in September quarter 2008. Nevertheless, the fall was only modest, as prices were continuing to be supported by booming investment in the resource sector and solid employment and income growth. However, the downturn in the economy during late 2008 and early 2009 adversely affected employment prospects and confidence, causing house prices to experience a sharper fall in December quarter 2008 and bottom out at a median value of $398,000.

To help support the Australian economy from the fallout of the GFC, the RBA dramatically cut the cash rate by 425 basis points, causing a corresponding 380 basis point fall in the housing variable rate between September 2008 and April 2009. This accordingly had a significant effect on improving the level of affordability in Brisbane. The sharp reduction in the cash rate coupled with the FHOGBS stimulated first home buyer activity and some price growth emerged in the first half of 2009 (+5%), although the median price still showed a decline of 0.2% over 2008/09 to be $419,000 at June 2009.

Given the improving outlook into the latter half of 2009, sentiment amongst upgraders and investors also improved. Accordingly, price growth in Brisbane continued to strengthen, with the median house price rising by 8% in the six months to December 2009. However, median prices have begun to stall in the first half of 2010, rising by only 2% in the six months to June 2010 for an annual rise of 10% in 2009/10. First home buyer demand has fallen off considerably upon the expiry of the FHOGBS, impacting on upgrader activity and turnover. Economic conditions in Queensland will also be slower to recover than some of the other states, with the next major round of resource projects yet to commence, and the tourism industry affected by the high value of the Australian dollar.

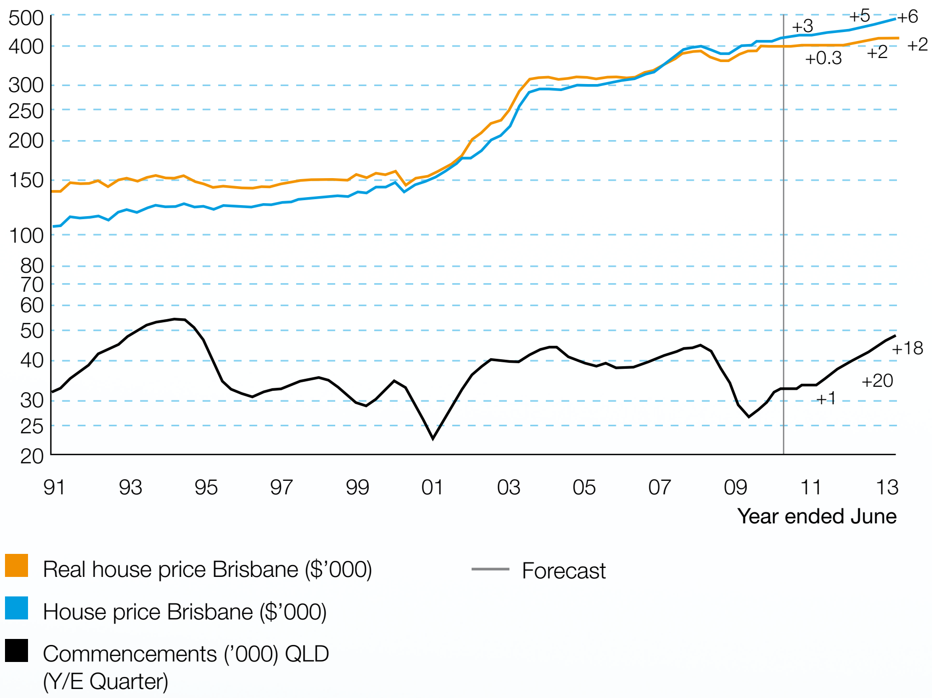
Together with some slowing of underlying demand due to lower interstate and overseas migration inflows, Brisbane's upturn is expected to be delayed, with price growth forecast to remain limited in 2010/11, rising by 3% for the year. In this period, low residential construction levels will nevertheless be resulting in the dwelling deficiency continuing to increase, with vacancy rates tightening. As local economic conditions continue to improve, this will help the upturn in price growth to start to accelerate, and the median house price is expected to rise by a more substantial 5% over 2011/12.

The expected pick up in investment in the next round of resource projects is projected to see mine expansions fully ramped up by 2012–13. Similarly, residential construction will also peak in this year, and these factors combined will drive strong employment and income growth. Subsequently, although interest rates are forecast to rise more sharply during 2012/13 and begin to impact on affordability, solid median house price growth of 6% is still anticipated to be achieved in Brisbane over the year—although will be slowing as the year wears on.

Despite substantial economic growth coming through by 2012/13, price growth will be more moderate than the rises that were evident prior to the previous peak in 2008. Affordability overall remains at a more challenging level, and this will keep price growth closer to income growth. Overall, the median house price in Metropolitan Brisbane is forecast to be $530,000 at June 2013, representing a total increase of 15%, or an average annual growth rate of 4.8%.

Chart 8: Brisbane dwellings, prices and activity

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



6. capital city overviews and price forecasts (cont.)

Adelaide

Chart 9 indicates that the median house price in Adelaide accelerated by 18% over 2007/08—the strongest growth of the Australian capital cities—to peak at $370,000 in June 2008. With Adelaide containing the lowest median house price amongst all mainland capitals, the effect of the rapid rise in housing interest rates during the first half of 2008 to peak at 9.6%, was less pronounced.

Nevertheless, the higher interest rates were having an effect, with price growth slowing in the first half of 2008, before falling in the second half of 2008, as confidence was dampened by the weaker economic climate and credit crisis across Australia. However, it should be noted that house prices remained relatively resilient, with the low in the median house price of $355,000 in March quarter 2009 just 4% below the peak nine months earlier.

The combination of sharp reductions in interest rates and the FHOGBS saw turnover in the Adelaide market pick up in the following three months. With first home buyers more prevalent, property demand was concentrated at the more affordable end of the market, evident by the median house price of Adelaide's outer suburbs passing their previous peak, while in inner and middle Adelaide suburbs were still slightly below their previous highs. Overall, the median house value in Adelaide was $360,000 at June 2009, down by almost 3% from the June 2008 peak.

As economic conditions improved from the second half of 2009, upgraders were encouraged to return to the market, supported by the pick up in demand from first home buyers due to the FHOGBS. However, the upward pressure on prices created by the boost to affordability from interest rates falling to 49 year lows resulted in the median house price growth in Adelaide rising by 8% in the second half of 2009.

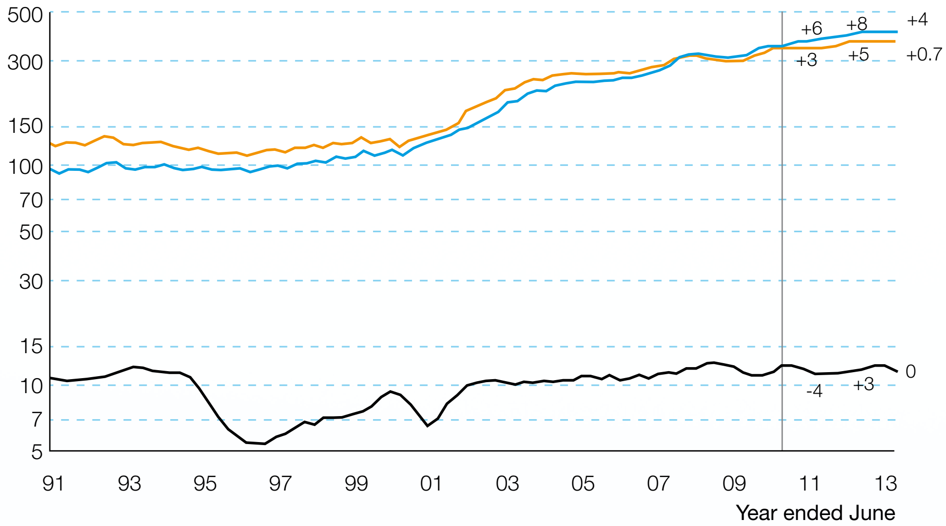
This pace of house price growth was maintained in the first half of 2010, with price growth being generally broad based across the Adelaide suburbs—possibly due to the disparity in values across Adelaide not being as large as the eastern state capitals and Perth. Overall, there has been solid annual growth of 14% in Metropolitan Adelaide's median house value to $410,000 at June 2010.

The rise in prices, as well as the rise in interest rates in 2009/10 has made affordability more challenging. Nevertheless, the boost to activity in South Australia—attributed to a major round of works taking place in rail, health, water, and defence infrastructure as part of State and Federal Government spending packages—is expected to drive solid household income growth. In addition, with just one 25 basis point interest rate increases forecast the first half of 2011, and a further three in 2011/12, affordability will remain conducive to price growth. As a result, Adelaide's median house price is projected to jump by 15% in this two year period—more than any other capital city.

With construction in the Adelaide market expected to remain high, there are few pent up demand pressures anticipated over the forecast period, and as interest rates are ratcheted up in 2012/13 as economic growth peaks, the rate of price growth is anticipated to ease to 4% for the year. Consequently, over the three years to June 2013, the median house price is estimated to increase by just under 20% to $490,000, reflecting average growth of 6% per annum.

Chart 9: Adelaide dwellings, prices and activity

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



Real house price Adelaide ($'000)

House price Adelaide ($'000)

Commencements ('000) SA
(Y/E Quarter)

Forecast

6. capital city overviews and price forecasts (cont.)

Perth

Strong wages and jobs growth in the state, driven by increased investment spending in the resources sector, saw Perth's median house price rise by a massive 174% between June 2001 and June 2007 (Chart 10). Accordingly, affordability in Perth had actually reached a critical point in 2006, and it was only Perth's booming economy that was supporting prices. The last gasp for prices came in 2007, when Perth's median house price peaked at $478,000 in the December quarter. This was only a 4% increase over the previous twelve months, and new dwelling construction was already falling by this time.

Similar to the rest of the country, the run up in interest rates over 2007/08, and subsequent impact of the GFC finally instigated a downturn in prices. The significant downturn in demand for resources, and the subsequent fall in commodity prices led to job shedding in the mining sector as projects were either abandoned, or placed on hold as they became unfeasible. As a result, the affordability issues finally came to the fore, and Perth's median house price fell by 12% to $420,000 in the year to December quarter 2008.

The combination of the FHOGBS and cuts to interest rates in 2008/09 stimulated activity at the lower end of the market, and Perth prices showed some recovery, rising by 7% in the first half of 2009, with the median of $450,000 at June 2009 representing a modest 2% rise for the year.

Confidence also began to improve over the back half of 2009, as commodity prices began to recover due to increased demand from China. This was particularly felt in the more affluent suburbs, which had experienced a sharper downturn at the onset of the GFC. Price growth in the six months to December 2009 accelerated at a stronger pace in inner Perth suburbs, where the median increased by 16%, as opposed to 6% growth in the median house price for outer Perth suburbs.

Nevertheless, even though the next round of mining expansion projects have been announced, and some have even commenced, it will take some time for them to reach their full employment stage, and subsequently have an impact on the residential market. Factors that are affecting the market presently are the expiry of the FHOGBS at the end of 2009, which is resulting in slowing dwelling sales turnover, while rises in interest rates have also impacted on affordability and dampened purchaser sentiment. Consequently, the 8% price growth in the second half of 2009 slowed to 1%, in the first half 2010, taking the median to $490,000 at June 2010, and resulting in an accumulated annual growth rate of 9% in 2009/10.

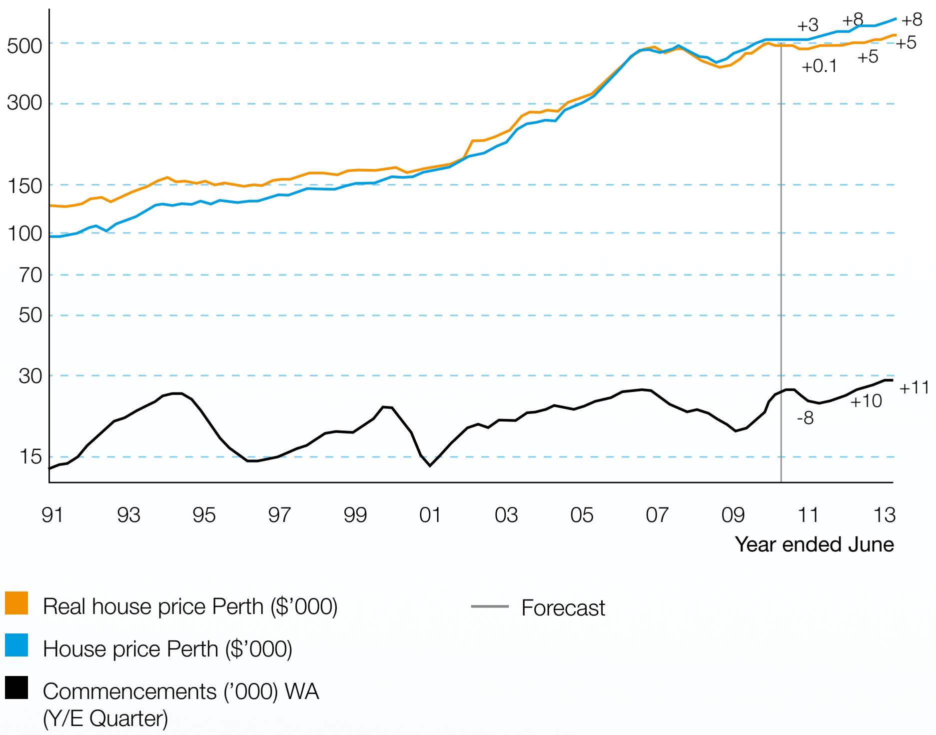
A slowing in the net intake from overseas migration, combined with more modest inflow of persons from interstate, is expected to take some heat out of residential demand in 2010/11, while economic growth will have been only slowly rising to underpin employment and income growth. Consequently, the median house price is expected to lift by a modest 3% for the year to $505,000 by June 2011.

Over 2011/12 inflationary concerns are expected to arise as economic growth nationally results in unemployment falling to below 5%. Accordingly the RBA is expected to increase the cash rate by a further 75 basis points. At the same time, however, the Western Australian economy is expected to begin outpacing national economic growth as mining investment ramps up, resulting in a forecast 8% increase in Perth's median house price over the year to June 2012. The rising dwelling deficiency and very strong employment and income growth is expected to underpin a further rise in the median house price of 8% in 2012/13, although forecast rising interest rates (in response to increasing inflationary pressures) peaking at above 9% will start to have an impact on price growth.

Overall, the median house price is expected to increase by 20% over the forecast period from the June 2010 median or by 6.4% per annum. This will take the median to $590,000 at June 2013.

Chart 10: Perth dwellings, prices and activity

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



6. capital city overviews and price forecasts (cont.)

Hobart

Chart 11 indicates that Hobart's median house price peaked at $335,000 in March quarter 2008, representing a rise of 14% over the previous twelve months. An important determinant of price growth in Hobart has been the city's long standing affordability advantage in comparison to most other capitals, and in particular over the eastern seaboard states. When affordability is most attractive, migration inflows from other states increase, as people seek more affordable housing in Hobart. This underpinned the buoyant Hobart market in this period.

However, the rapid rise in housing interest rates over 2007/08 to a high of 9.6%, combined with the significant level of price growth during that year, eroded much of Hobart's affordability advantage. Additionally, a slowdown in economic conditions further discouraged people to move interstate. Subsequently, house prices continually eased during the following year, with the median house value declining by 6% to a low of $315,000 in March quarter 2009.

This fall in prices and the swift reduction in housing interest rates during late 2008 and early 2009 led to a dramatic improvement in affordability. As a result, purchaser sentiment rose, in particular that of first home buyers who were further enticed to buy with the implementation of the FHOGBS. This led to strengthened demand for more affordable dwellings, and the 6% quarterly rise in house prices in outer Hobart suburbs in June quarter 2009 outpaced that of inner and middle suburbs of Hobart. The recovering demand was sufficient to lift Hobart's median house value to $336,000 at June 2009—a rise of 3%, and just past its March 2008 peak.

Price growth continued to accelerate in subsequent quarters, with the median house price peaking at $380,500 in March quarter 2010, reflecting an annual rise of 21%. The rise was underpinned firstly by the stronger first home owner demand, and subsequently upgrader demand, as rising prices encouraged home owners to trade up to higher priced dwellings. This was highlighted by the 27% surge in the median house price in inner Hobart suburbs over the year to March 2010.

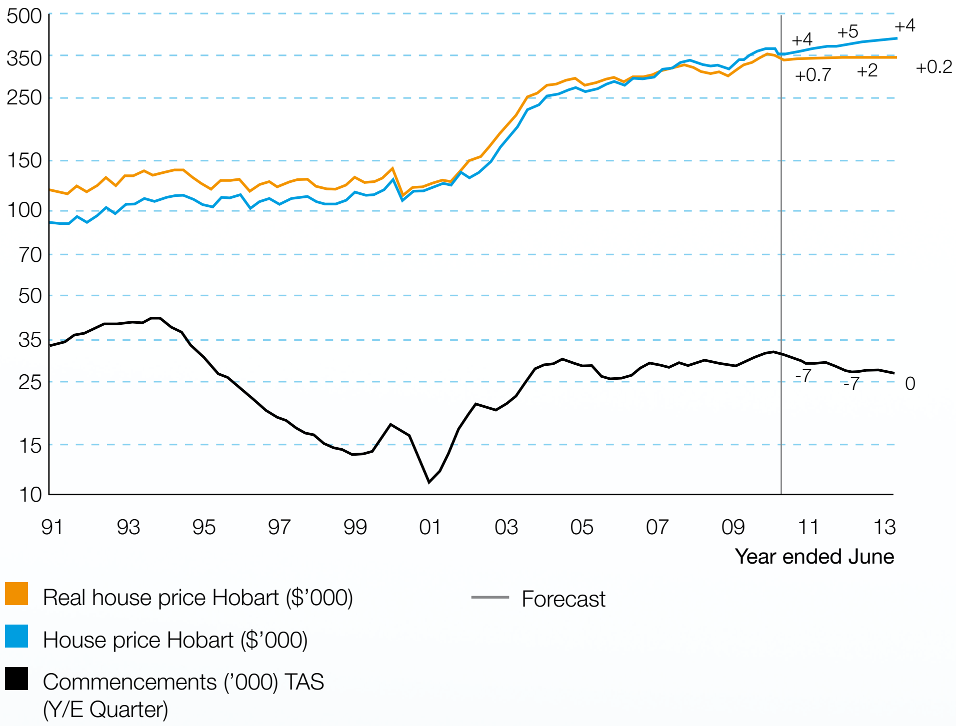
The fall off in first home buyer demand after the expiration of the FHOGBS at the end of 2009 has resulted in turnover declining in 2010. In addition, the cumulative impact of the substantial price growth and a rapid rise in housing interest rates is placing pressures on affordability. This appears to be reflected in the median house price figure in June quarter 2010, which fell by 4% from the preceding quarter to $366,500, resulting in a more moderate annual rise of 9%. The loss is expected to be largely recovered in 2010/11, with only one 25 basis point rise in interest rates anticipated and strengthening economic conditions causing confidence to recover. This will take the median to a forecast $380,000 at June 2011—a rise of 4%.

Nevertheless, Hobart will remain more affordable relative to the other state capitals, and the potential for further price growth exists as the economic environment improves. However, the stronger early price growth through the start of the economic upturn during 2009/10 is expected to flatten out the residential cycle going forward. This will limit the increase in prices to a forecast 5% in 2011/12 to a median value of $400,000 at June 2012.

Further strengthening in economic growth in 2012/13 will begin to create labour shortages and wage-cost inflationary pressures. In response, the RBA is expected to enter another round of sharper interest rate rises, with the variable rate forecast to peak at 9.1% by June 2013. Given the level of house price growth in the preceding years, affordability will again become strained, causing price growth to ease to a forecast 4% in 2012/13. This will result in the median house price rising to $415,000 by June 2013, reflecting total price growth of 13% over the three years to June 2013, or average growth of 4% per annum.

Chart 11: Hobart dwellings, prices and activity

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



6. capital city overviews and price forecasts (cont.)

Canberra

Price growth accelerated by 12% in 2006/07 as a deficiency of dwellings emerged, and was largely a result of residential demand strengthening as the net interstate migration outflow becoming an inflow in 2006/07 (Chart 12). The strong price growth continued in the second half of 2007, with the median house price peaking in the December quarter 2007 at $488,500, before weakening in the six months to June 2008 as variable rates moved up beyond the 9% mark. Prices for much of 2008/09 remained weak as the intensification of the GFC impacted on sentiment, with the median price falling by 4% for the year.

The Australian Capital Territory experienced the largest surge in demand from first home buyers due to the FHOGBS as the Territory attracts many residents from other states into Federal Government employment, and it is likely that many from this group took the opportunity to purchase rather than remain in long term rental.

In addition, vacancy rates in Canberra tightened further to 1.0% at December 2009, reflecting the rise in the deficiency in dwelling stock. At the same time, concerns about employment prospects in Canberra due to the GFC were likely to have dissipated as Federal Government stimulus spending ramped up and created more jobs to support it. As a result, price performance was strong in Canberra in the six months to December 2009, with the median house price rising by 9% to $491,000. This is further evident with prices in the inner south suburbs increasing by 40% and the west and north regions increasing by 16% over the twelve months to December 2009.

However, with the FHOGBS having expired at the end of 2009, and interest rates also rising through 2009/10, the rate of price growth slowly eased over the first half of calendar 2010. Nevertheless, the rise in the median house price of 7% recorded over the six months to June 2010, took the median house price to $525,000 at June 2010—a rise of 17% for the year.

The rate of price growth is subsequently expected to taper off over the entire forecast period. Federal Government spending is expected to be more constrained as the Federal Government moves to bring the budget back into surplus. Over the next three years, interest rates are also expected to continue to be edged upwards, to eventually peak at a 9.1% by 2013. This will have a dampening effect on prices through this period. Nevertheless, improving economic growth nationally will continue to support prices.

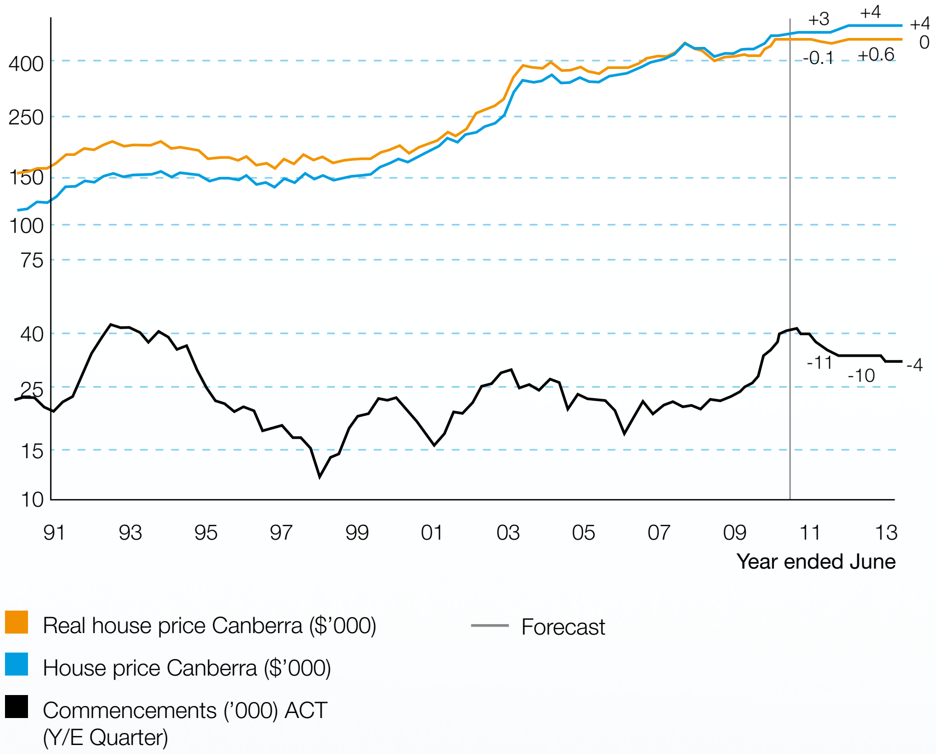
Consequently, the median house price is expected to rise by 3% in 2010/11 to $540,000 at June 2011, with the lower presence of first home buyers at the more affordable end of the market keeping overall turnover down. However, first home buyer demand should be moving back to long term levels by 2011/12, and economic growth will also be improving. The RBA is also expected to be a lot more wary about Inflationary pressures, raising the cash rate by 75 basis points over the year in an attempt to moderate economic growth. These two factors will offset each other, and growth in the median house price growth is forecast to be a moderate 4% in 2011/12.

With the CPI rising to 3.5% nationally and subsequently above the RBA's upper threshold level, a more aggressive 100 basis point rise in the cash rate is expected. This will consequently take the cash rate to 6.5% and the variable housing rate to 9.1%. Accordingly, this will deteriorate the affordability level and maintain median house price growth at a modest 4% in 2012/13. Economic conditions are forecast to be peaking nationally, and this should prevent negative prices.

Overall, Canberra's median house price is forecast to increase by a total of 11% to $580,000 at June 2013, reflecting an average annual increase of 3.4% over the three year period.

Chart 12: Canberra dwellings, prices and activity

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



6. capital city overviews and price forecasts (cont.)

Darwin

Darwin was the only capital city to show consistent solid quarterly growth in its median house price throughout 2008/09, with prices increasing by 11% over the financial year (Chart 13). Continual robust residential property demand through the GFC induced economic downturn was supported by employment holding up well in key local industries such as defence and public administration. In addition, Darwin's economy is driven more by the oil and gas sector, which had not suffered the weakness in prices that developed for bulk commodities such as iron ore and coal during the year. Consequently, the city had not been as affected as the other resource–based centres of Perth and Northern Queensland.

Darwin is emerging as a major supply and service centre for the oil and gas industry. Currently, significant work is being done on developing a supply base, which will include the necessary infrastructure and facilities to supply off–shore operations. Combined with the Territory Government funding, the Federal Government will also be spending significant amounts in the coming years in areas such as port expansions, health and defence projects, which should lead to improving economic growth once finance availability conditions become less restrictive.

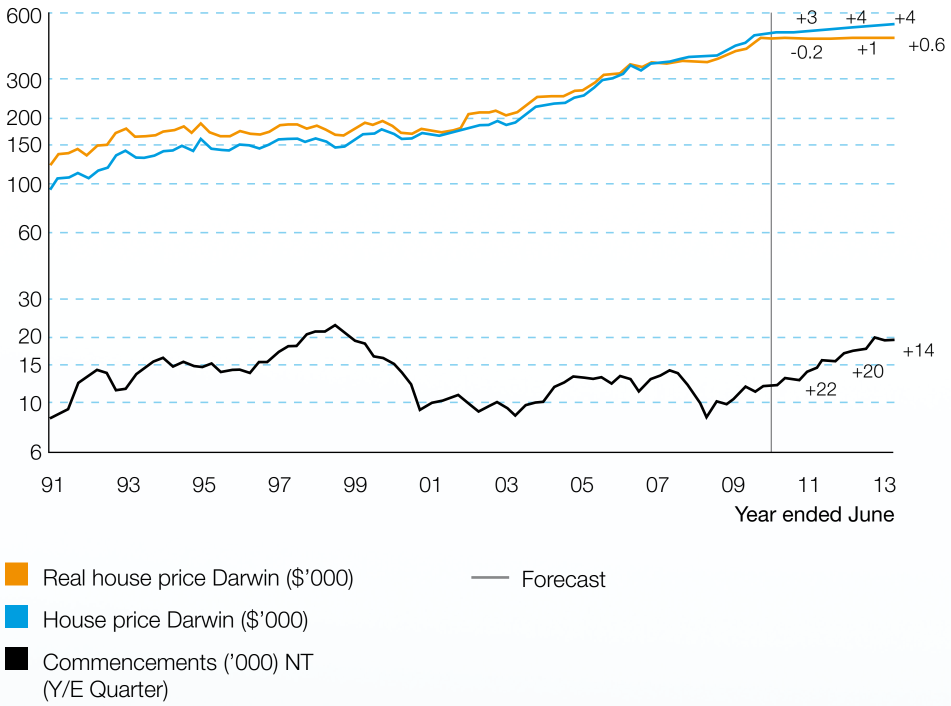
The rapid cuts to housing interest rates over late 2008 and early 2009 led to attractive affordability in Darwin heading into 2009/10. Furthermore, the Territory budget in 2009/10 made provisions for a record infrastructure investment of $1.3 billion in key priorities including housing, education, health, roads and the community. The boost to employment derived from increased government spending in important services, combined with further employment growth in the key resource sectors, fuelled additional housing demand. As a result, significant house price growth of 18% came through 2009/10, with the median value rising to $555,000 at June 2010.

Economic growth in the Northern Territory is expected to ease over 2010 as the credit crisis experienced by Australia has delayed commencement on the next round of major investment projects due to the difficulty in accessing finance. This has created a brief gap in activity from when the previous large projects were completed during 2009, and local economic growth has moderated.

Additionally, the considerable house price growth in Darwin during 2009/10 and the 150 basis point increase in the cash rate (and 160 basis point rise in housing variable rates) have resulted in significantly poorer affordability heading into 2010/11 compared to the previous financial year. Indeed, on the affordability measures indicated earlier in this report, affordability in Darwin is at its worst point on record. This has already resulted in price growth beginning to slow in the first half of 2010, which is expected to continue in the short to medium term. As a result, Darwin is forecast to witness a modest increase in its median house price of 3% in 2010/11.

The increase in infrastructure spending, and flow on benefits of greater job creation, is expected to strengthen property demand in Darwin. However, the long lead time for these projects means that the flow on effects will take some time to come through. Nevertheless, residential construction activity, although robust, has been below underlying demand and a shortage of residential dwellings remains. This will maintain some moderate price growth until the next round of resource expansion projects kick in. Darwin's median house price is forecast to increase by 4% in both 2011/12 and 2012/13. By June 2013, Darwin's median house price is projected to reach $620,000, which would equate to total growth of 12% over the three years to 2012/13, or an average rise of 4% per annum.

Chart 13: Darwin dwellings, prices and activity
Source: Australian Bureau of Statistics, Real Estate Institute of Australia and Forecasts: BIS Shrapnel



Imi notes

lmi about

QBE LMI

Operating for over 45 years, QBE LMI has combined its risk management expertise, depth and breadth of market knowledge and financial strength to serve the evolving needs of our clients through all stages of the economic cycle.

Our products and services support the mortgage industry by reducing the inherent credit risk in mortgage lending. We are committed to protecting mortgage lenders, giving them the security and confidence to be responsive to changing needs of borrowers and offer higher Loan to Value ratio loans both now and in the future.

Our strong reputation for service and innovation and ability to identify, develop and roll-out flexible products and services, means we can adapt and evolve with our clients' developing needs and help them securely grow their business.

We provide lenders' mortgage insurance to the lending industry in Australia, New Zealand and Hong Kong and operate as a wholly owned subsidiary of the QBE Insurance Group.

QBE – some key facts

Our parent, QBE, is one of Australasia's leading companies. These core facts about QBE give you an idea how their involvement supports the confidence in QBE LMI's offering:

- QBE Group is a top 25 company in the global insurance and reinsurance market
- The QBE Group has been listed on the Australian Stock Exchange for over 30 years
- QBE operates in all key insurance markets
- QBE has offices in 49 countries in Asia Pacific, the Americas and Europe
- QBE employs over 13,000 staff worldwide

lmi talk soon

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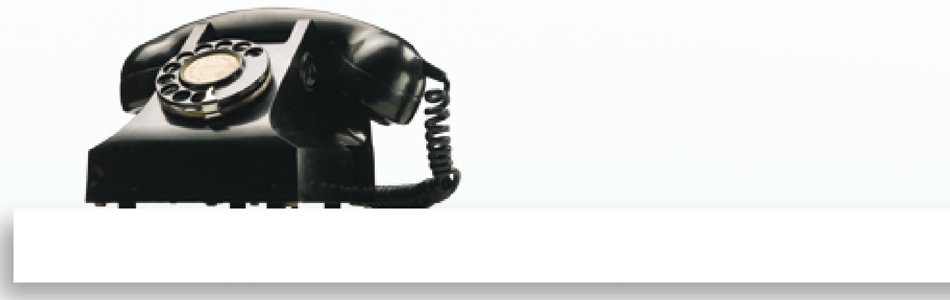

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