

QUICK STATS

	Change From	
	1/2 Yr.	Yr.
Median Price Houses	→ ↑	↑
Median Price Units	→ ↑	↑
Rents Houses	↑	↑
Rents Units	↑	↑
Vacancy Rates	→ ↓	↓
Yields	↑	↑

* The arrows are trend indicators over the specified time period and do not represent a positive or negative value. (eg., absorption could be negative, but still represent a positive trend over a specified period.)

HOT TOPICS

- Sydney's Inner vs. Western Suburb Battle
- Newcastle's Residential Market Pushes Ahead
- Sydney's Unit Market Softens
- Wollongong's Demographic Profile Changing
- Market Outlook for 2008

MARKET OVERVIEW

Australia's residential market has strong demand but supply remains constrained. This imbalance is being driven by international migration, none more evident than in New South Wales (NSW).

NSW struggles with housing affordability a key factor in high levels of interstate migration, although this exodus to other states is more than offset by overseas immigration into the state. While Sydney continues to have the lowest population growth rate of all mainland capital cities, NSW grew by more than 70,000 people over the past year. This migration trend into NSW is adding to the physical demand for property in a state that is in parts suffering from a growing imbalance. The housing market has reached a shortage of just under 50,000 dwellings in 2007, the most pronounced imbalance in the country.

The level of housing starts in NSW remains remarkably weak. However, according to the Australian Bureau of Statistics, the trend estimate for total number of dwellings approved in NSW rose 1.7% in January 2008 and has risen for the past six months. The trend estimate for the number of private sector houses rose 0.3% in January and has also risen for six consecutive months. Steady population growth in the state is not projected to close the gap with national gains but the gap has narrowed over the past year and a half.

The demand for housing from owner occupier buyers, is being driven by a number of key

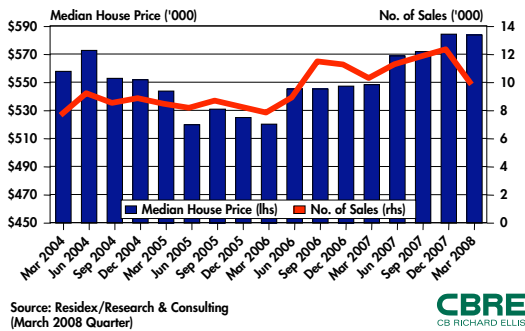
factors: population growth; higher incomes supported by generous tax cuts; 34-year low unemployment (March 2008 unemployment rate was 4.4%); and a willingness to take on debt due to strong household balance sheets. Such factors may hinder the market, deterring investment in the construction of residential stock and exacerbating the housing affordability problem. However, the lack of investment attention and limiting rental properties is due to the escalating cost of debt and affordability of properties.

"Growth has been patchy with relatively soft prices in the west, contrasting with stronger price rises in the inner and eastern suburbs."

The shortage of housing in NSW and increasing tenant demand has once again placed Sydney houses as the least affordable in the nation. However, the residential market has relaxed in 2008 with Sydney's median house price at \$584,000, falling by 0.15% in the March 2008 quarter. Growth has been patchy with relatively soft prices in the west, contrasting with stronger price rises in the inner and eastern suburbs. This split market has kept a lid on Sydney's median house price, with affordable house sales dominating and suppressing any significant median price rise for Sydney as a whole.

Mortgage defaults have risen to record levels, especially within Sydney's vast "mortgage belt", encircling the west and south-west of the metropolitan region. Such effects are causing significant indecision by first home buyers to enter into the market, putting further pressure on the rental market. This has kept vacancies extremely low and resulted in rents continuing to increase.

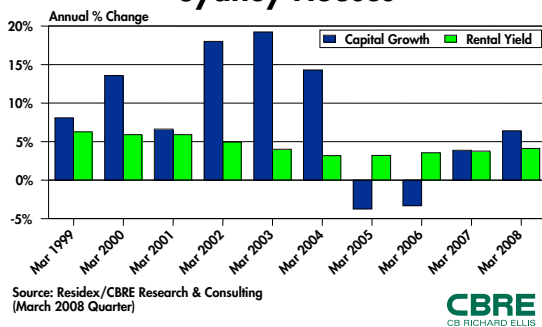
Sydney Median House Price and Sales



SYDNEY HOUSE & NEWCASTLE MARKET Sydney House Price and Sales Volume

What ended as a reasonably good year 2007 had all the promises of continuing into 2008, however this was not to be. With nearly 44,000 house sales recorded over the past twelve months, an increase of 20% over the year before – 2008’s first quarter could not follow through. The March 2008 quarter saw 9,657 house sales, a drop of 2,509 sales compared to the December 2007 quarter. Another possible sign of Sydney’s susceptibility to interest rate changes was the neutral median house price. Following December’s median price of \$584,500, the March quarter experienced a 0.15% decrease, producing a Sydney median house price of \$584,000. As Sydney is becoming accustomed to a two tiered market, its capital growth rates were not constant throughout. Suburbs in the inner, eastern and inner west showed growth of around 13% over the year and above average growth in other upper socio-economic suburbs. As expected, the impact of interest rates hit hardest in the western and south-western suburbs, where there have been falls in price over the year to March 2008.

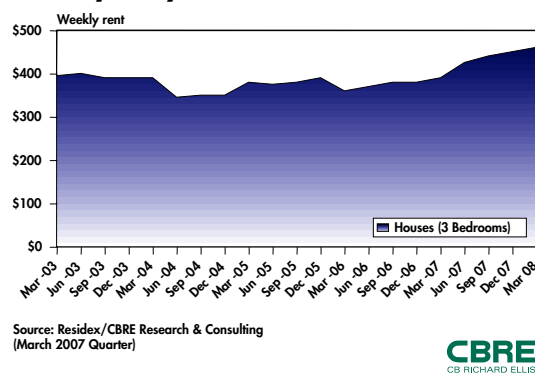
Capital Growth vs. Rental Yield Sydney Houses



Capital Growth and Rental Yields

Overall, Sydney houses saw capital growth of 6.39% over the year to March 2008, a vast improvement from March 2005 to March 2007 where the annual capital growth rate ranged from -3.74% to 3.87%. In comparison to the capital growth, rental yields continue their upward trend sitting at 4.11%. Not since March 2002 has Sydney seen rental yields over 4%. The March quarter yield figures still place Sydney toward the bottom of the capital city ladder, only higher than Perth (3.31%) and Melbourne (3.79%). Sydney’s increase in yield is a run-off effect from the tightening rental market and resulting increasing rents.

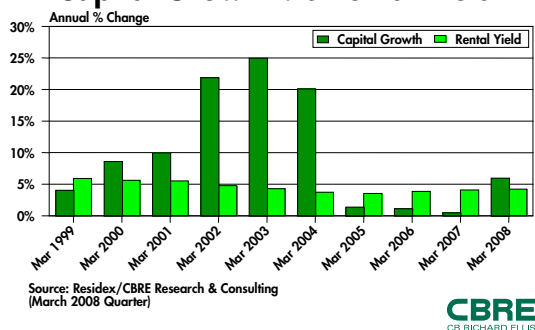
Sydney Median House Rents



Rents and Vacancy Rates

Rents have continued to increase, reflecting the tight rental market and lack of accommodation available. The March 2008 quarter continued this trend with Sydney house rents increasing \$10, bringing the weekly median rent to \$460. These continued rent rises keep Sydney as the most expensive capital city to rent a house as well as to buy one – adding pressure to a boiling rental market. The March 2008 REINSW vacancy rate results showed the availability of rental accommodation in Sydney remained stable at 1.0% from the previous quarter. Vacancy rates lower than 3% indicate a strong demand for rental accommodation. With Sydney’s extreme housing shortage, vacancy rates are expected to remain low, further pushing rents higher.

Newcastle Houses Capital Growth v's Rental Yield



Newcastle’s Residential Market

Newcastle’s economy is booming, due in part to the financial run-off from the resource rich states. With the largest coal exporting harbour in the world and the increasing demand escalating coal prices, Newcastle’s development and employment are growing. The population in Newcastle is increasing faster than Sydney, with a current estimated resident population of 522,000. The median house price rose just over 6% within the twelve months to March 2008, the most significant rise since 2004. The number of houses sold in the year to March 2008 increased dramatically, totalling 6,292 as opposed to 5,887 in the twelve months to March 2007. The median house price for the March 2008 quarter was \$359,500 and the weekly median rent for a three bedroom house was \$290, providing a rental return of 4.2%. With a thriving economy, increasing population and well positioned residential market, it is anticipated that the boom in coal export prices is likely to make Newcastle a future hot spot for investors.

SYDNEY UNIT & WOLLONGONG MARKET

Sydney's Unit Price and Sales Volume

Last year Sydney unit sales increased a whopping 25%, the largest increase of any state capital city. However, during the March 2008 quarter, sales plummeted by 25% as interest rate rises kicked in. This fluctuation cancelled 2007's sale activity out. This produced capital growth of 0.33% for the March quarter 2008. A result of this sluggish environment has been the dethroning of Sydney's median unit price to second on the capital city rankings. Perth is now the most expensive city to purchase a unit with a median price of \$409,500, followed closely by Sydney at \$402,000. Repeating the trend seen with Sydney's housing market, unit price growth has been far from even, with units in the more sought after suburbs continuing to grow in value.

Unit Rents and Yields

A result of rents increasing was Sydney's March quarter rental yield reaching 5%. The marked rental yield improvement resulting from the 10% rise in rents experienced over the past twelve months. Another rise of \$5 per week increased the weekly median rent to \$385 over the March 2008 quarter, placing Sydney's rent second behind Canberra at \$415 per week. Unit rent rises have followed demand with harbourside, beachside and bayside suburbs increasing by up to \$80 per week during the year to March 2008. This is driven by the cashed up generation x and y renters, seeking out well located modern units in areas with lifestyle advantages and a trendy scene. Areas such as Coogee, Manly, Bondi, Dee Why and around the CBD (the Rocks, Surry Hills, Rushcutters Bay) are experiencing demographic changes as the young infiltrate these areas.

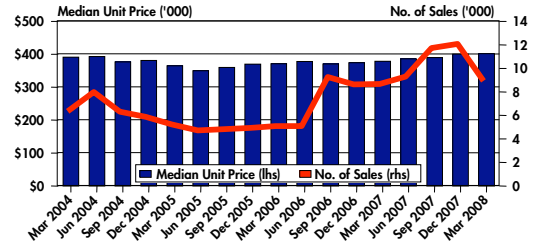
Sydney's LGA Unit Supply Pipeline

With Sydney's housing affordability at an all time low, units are proving to be a more affordable option. With increasing development costs and the tight borrowing restrictions, it is predicted one in three proposed residential projects will be deferred or abandoned are likely to fall over in 2008. The overall belief is that some developers are obtaining the necessary development approvals ready to move when the market dictates or suits them. Such activity adds further pressure to an already unbalanced supply and demand scenario. From May 2007 to May 2008 Sydney LGA had a total of 12,977 new residential units in the development pipeline (projects with greater than 50 units). Across the 49 proposed projects, the majority are located in the suburbs of Sydney, Waterloo and Zetland. Of those projects, 19 have development applications lodged, 19 have development approval, five have tenders called or contracts issued, and six are currently under construction. All proposed projects have an estimated scheduled completion due from 2008 to 2012. Not all proposed projects will be constructed with a possible third being deferred or abandoned for various reasons.

Wollongong's Residential Market

One could be mistaken when comparing Wollongong to Newcastle that their residential markets are the same. Both are thriving industrial hubs – one known for coal and aluminium, the other for steel and to a lesser extent coal mining and exporting. Wollongong's youth are drawn to Sydney in search of education, employment and lifestyle, resulting in the city having one of the lowest population growth rates of any major coastal city in NSW. Not to mention that the population of around 280,000 is rapidly aging. Such demographic changes are not having a positive impact on the residential market. Capital growth for the year to March 2008 was a neutral 0.05%. The median house price for the March 2008 quarter increased to \$378,000 after 653 sales increased the capital growth by 1.01%. Renting a three bedroom home in Wollongong is considerably cheaper to Sydney costing \$280 per week, proving a rental return of 3.9% (lower than that of Sydney and Newcastle).

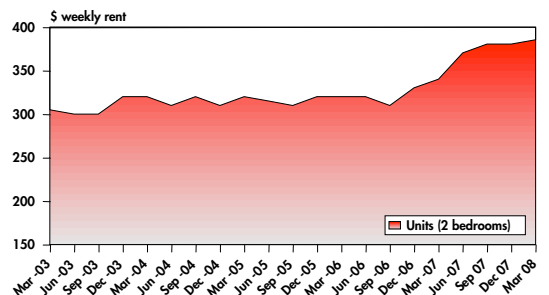
Sydney Median Unit Price and Sales



Source: Residex/CBRE Research & Consulting (March 2008 Quarter)



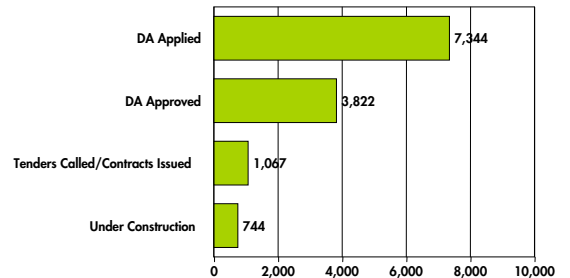
Sydney Median Unit Rents



Source: Residex/CBRE Research & Consulting (March 2008 Quarter)



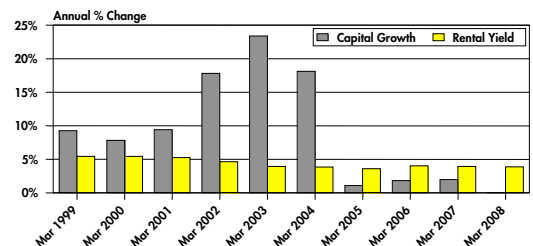
Sydney LGA Unit Supply Pipeline



Source: Cordells/CBRE Research & Consulting (May 2007 to May 2008)



Wollongong Houses Capital Growth v's Rental Yield



Source: Residex/CBRE Research & Consulting (March 2008 Quarter)



MARKET OUTLOOK

With Sydney's undersupply of rental housing continuing and the halted Sydney median prices – what lies ahead in 2008?

Sydney predominantly has two residential markets. During 2007 there were signs of a recovery, particularly in areas within 10 – 12 km of the CBD. Historically market movements in Sydney commence in the Eastern Suburbs (Bondi areas) and gradually move west in a wave like manner. The best example of that in recent times is the rental crisis Sydney is currently experiencing. Investors have generally exited the market, a result of the vendor exit tax by the NSW State Government in July, 2004. In many respects Sydney is feeling the affects of that.

However, the outlook for the NSW rental market remains optimistic due to low vacancy rates keeping the market extremely tight and increasing rents which in turn improve rental yields. House and unit price growth is likely to soften over the remainder of 2008; however it will continue to be supported by strong tenant demand and a lack of supply.

Throughout this report it is clear that the Sydney residential market cannot be painted with the same capital growth brush. Those living in the mortgage belt areas, the western and south-western suburbs, are struggling against rising mortgage repayments caused by the recent interest rate rises. The Reserve Bank's recent announcement to hold interest rates with no short-term foreseeable change was likely to have been a welcome relief to this sector. Whereas, those located in the inner, eastern and inner west suburbs of Sydney are likely to be less impacted. Property price growth and high demand in these more affluent suburbs continue to line owners' pockets.

Sydney's first quarter of 2008 experienced a significant halt on off-the-plan sales as well as residential development site sales. This was brought about by the increasing interest rates together with uncertainty of the sub prime crisis, largely experienced within the US, and the stock market collapse here in Australia. With many investors affected by margin calls, a significant drop so far in 2008 for residential sales has been noted, especially within the eastern suburbs, north shore and northern beaches. This has been confirmed from discussions with sales and marketing managers for the major development companies here in Sydney.

“With Sydney's undersupply of rental housing continuing and the halted Sydney median prices – what lies ahead in 2008?”

The stock that is generally not or at least minimally affected by the interest rate rises tends to be studio

and one bedroom apartments, where the rent from these apartments tends to assist with a large proportion of the mortgage. Premium three bedroom apartments in the \$1million to \$3million range are proving popular. With retirees downsizing into apartments. They are using the equity in their homes to purchase these properties outright. The two bedroom apartments appear to be the hardest stock to sell in the current market. Additionally, discussions with real estate agents have revealed that many families are selling and moving into slightly cheaper suburbs due to mortgage stress, now significantly effecting household budgets.

CB Richard Ellis believes that the slowdown in the residential sector will continue and the outer market will impede the overall Sydney median house price from increasing significantly in 2008. It can be expected that the middle to upper tier of the market will continue to experience steady growth thanks largely to solid demand.

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