

MarketView

NSW Residential

Hot Topics

- New South Wales housing starts to recover but still remain well below the 20 year average
- Sydney house and unit sales volume at their highest levels since 2003
- Median value increases also show their best annual result since 2003
- Rental growth moderates
- Sydney residential vacancy rates edges up slightly to 1.6% at November 2009

Market Overview

The Australian economy showed surprising resilience over the latter part of 2009. With the threat of a recession, be it technical or otherwise, seemingly passed, the economy heads into 2010 with a much more positive outlook. Government stimulus handouts, the temporary increase in the First Home Owner's Grant and the generational low interest rate setting all helped to support a generally resurgent residential market in 2009. This played a major role in the country avoiding the dreaded recession.

With the effects of the stimulus packages now largely through the system and interest rates climbing towards what is expected to be a neutral setting of between 5.0% and 5.5%, however, 2010 does appear to present a mixed and challenging environment for the residential markets.

The boost to the First Home Owner's Grant did indeed prove significant during 2009, providing support to a recovery in sales volumes, particularly in the sub-\$500,000 bracket, and increases in median house and unit values. While the grant has now returned to pre-boost levels, the ripple effects had begun to spread into the \$500,000 plus market by the end of the year.

Although first home buyers have begun to retreat – in November 2009 the first home buyer percent of dwellings financed had dropped to 22.1% nationally from their mid-2009 highs of above 28% - there is still solid momentum underway in many states. This is likely to continue into the first part of 2010 as investors re-emerge. In many ways, however, it appears that while 2009 was characterised by efforts to re-invigorate the housing market, 2010 may well be marked by efforts to slow down the current pace.

Interestingly, residential markets nationally have acted quite uniformly since the onset of the global financial crisis. Rising interest rates, and the varied pace of recovery in individual states, including the impact of employment, are likely to see greater levels of divergence between states emerge in 2010, driven by local economic conditions.

Sales volumes during 2009 for both houses and units appear to have been boosted significantly as a result of the now ended higher First Home Owner's Grants. According to Residex, the number of house sales in the Sydney market during 2009 totalled 45,832, a figure 21.9% higher than the 2008 total and the highest number of sales since 2003. A slightly higher number of units, 46,917, were sold during the year. This tally was 25.6% above the 2008 figure, and was also the highest annual sales volume since 2003.

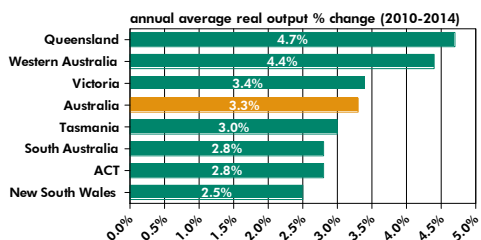
The December quarter 2009 median house value for Sydney, as reported by Residex, had risen by 3.6% over the quarter and by 12.8% on an annual basis to \$632,000. This compares with a 4.2% decline in 2008. The Residex measure of Sydney unit values recorded a 10.4% increase over 2009 to reach \$436,500 at the December quarter. For both measures, the growth was the best annual result since 2003.

Rental data from the New South Wales Department of Housing highlights a general moderation in the rate of increase in median rents during 2009. At the September quarter 2009, the median rent for a three-bedroom house in Sydney sat at \$350 per week, up by just \$10 per week since the March Quarter. The median rent for two-bedroom units sat at \$400 per week, unchanged since the start of 2009.

The overall Sydney vacancy rate at the September quarter 2009 was 1.3%, according to the Real Estate Institute of Australia. Sydney's vacancy rate has remained tight at around this level, fluctuating between 1.0% and 1.5%, since the end of 2006. Later data from the Real Estate Institute of New South Wales shows a slight increase in the vacancy rate, to 1.6%, at November 2009.

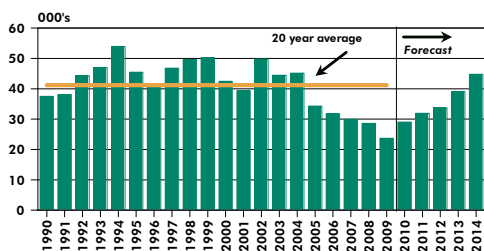
After a decline in 2008, the median value of both houses and units in country New South Wales recorded a modest increase in 2009, according to Residex. The median value of country houses at the December quarter 2009 was \$328,000, with growth of 5.7% generated over the year. Country units recorded a median value of \$292,500, with annual growth of 4.6%.

Average Annual Economic Growth 2010-2014



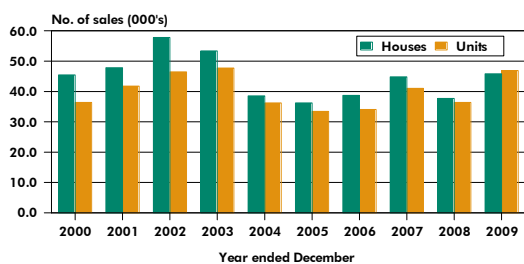
Source: Access Economics (January 2010)

Housing Starts New South Wales



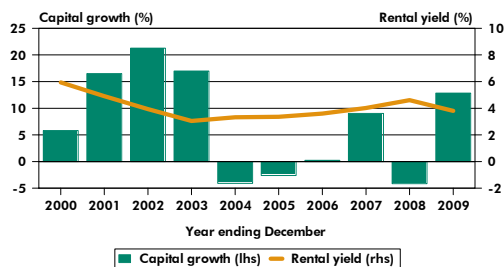
Source: Access Economics - January 2010

Annual Sales Volume Houses and Units, Sydney



Source: Residex (December Quarter 2009)

Capital Growth And Rental Yield Sydney Houses



Source: Residex (December Quarter 2009)

New South Wales economy expected to grow

The recovery from the global recession of 2008-09 has begun, with Australia leading the rest of the world after avoiding negative economic growth during the 2009 calendar year. Continuing strong demand for resources from China is likely to be a major factor in a prolonged recovery for Australia. This will be necessary as the positive effect of the economic stimulus measures disappear. According to Access Economics from 2010 to 2014 real output for the Australian economy is expected to grow at an average rate of 3.3% per annum. This compares with an average of 2.7% per annum from 2005 to 2009. For New South Wales, despite recovery, growth is still expected to lag the nation at just 2.5% per annum from 2010 to 2014 according to Access Economics. This is, however, noticeably stronger than the 2005 to 2009 rate of 1.6% per annum. Slow growth has been the result of a number of factors including relatively subdued population growth, structural declines in manufacturing and agriculture, fiscal imbalances that have restricted infrastructure spending and the resultant capacity constraints that emerged.

Housing starts forecast to rise in 2010

Although the pickup in population growth still leaves New South Wales's population growth below the national rate, that gap has been closing, and the State's population growth is the best since 1988. Construction, however, has been very weak. With rising demand and weakening supply, rents rose and rental vacancy rates fell. These pressures have started to see the forward indicators of construction lift. Population gains are expected to combine with still low interest rates to generate a pick up, although the lift in construction may continue to lag demographic demand for a while further amid current difficulties in getting finance for development. That said, credit constraints are not going to be a problem forever, and New South Wales has got further than most other States to catch up to its underlying need for new homes. Hence, housing starts may rise 22.4% in 2010 and 10.1% in 2011 according to Access Economics. Even so, that will only take the level of starts back to where it was in 2006.

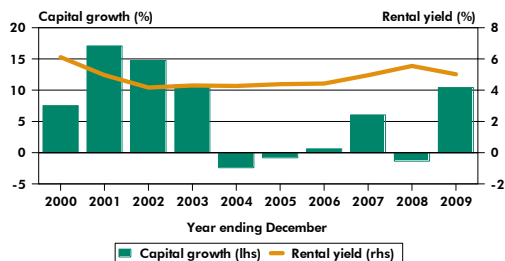
Sales volumes boosted by higher first homeowners grant

Sales volumes during 2009 for both houses and units appear to have been boosted significantly as a result of the now ended higher First Home Owner's Grants provided by the Federal Government. According to Residex, the number of house sales in the Sydney market during 2009 totalled 45,832, a figure 21.9% higher than the 2008 total and the highest number of sales recorded since 2003. A slightly higher number of units, 46,917, were sold during the year. Again, this tally was well above the 2008 figure, by 25.6%, and was also the highest annual sales volume since 2003. Interestingly, this is the first time in more than a decade that the annual sales volume for units has exceeded that of houses. Sydney was the second most active capital city housing market, behind Melbourne, and accounted for 13% of all sales (capital city and regional) nationally. In terms of units, Sydney was by far the most active market and accounted for 33% of all sales nationally.

Sydney median house value increases by 12.8%

The December quarter 2009 median house value for Sydney, as reported by Residex, rose by 3.6% over the quarter and by 12.8% on an annual basis to \$632,000. This compares with a 4.2% decline in 2008 and represents the strongest annual growth result since 2003. Growth over the past 10-years has averaged 6.8% per annum, although most of this was driven by the performance between 2000 and 2003. The Sydney median value remained the highest of all capital city markets and high when compared with the national median of \$420,500. In term of growth during 2009, Sydney was the third strongest of all the capital city markets, only slightly behind Darwin (with a 14.9% increase in value) and Melbourne (with 14.3% increase). Nationally, the median house value increased by 6.8% over the year to December 2009. With a \$35 per week decline in median rent, however, to \$460 per week in the December quarter, the rental yield had fallen to 3.80% compared with 4.61% twelve months earlier. This decline in rental yield is the first recorded since a five-year period of gradual increases commenced post-2003.

Capital Growth And Rental Yield Sydney Units

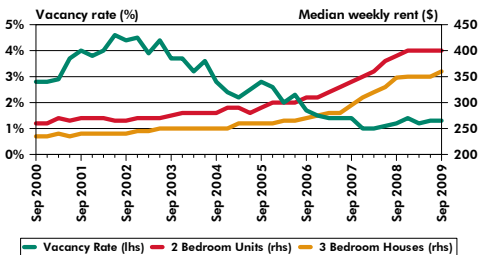


Source : Residex (December Quarter 2009)

Sydney unit value increases by 10.4%

The Residex measure of Sydney unit values recorded a 10.4% increase over 2009 to reach \$436,500 at the December quarter. This compares with the 10 year average growth of 6.1% per annum. The annual growth figure, as with the Sydney house market, is the strongest annual result since 2003. Again as for houses, four of the five years preceding 2009 generated either a fall in value or just a marginal rise. Sydney's median unit value remains the highest of any capital city market and is high compared with the national median of \$371,500. The 2009 growth result was solidly above the 6.3% increase recorded nationally. The median weekly rent for a Sydney unit sat at \$420 in the December quarter, unchanged from a year earlier. As a result, the rental yield has fallen to 5.02% compared with 5.55% in the December quarter 2008. The decline comes after a six-year period of relatively stable and then gradually rising yield.

Residential Vacancy Rate & Median Rents, Sydney

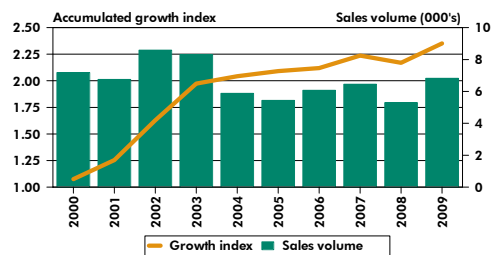


Source : REIA; NSW Department of Housing

Rental growth moderates as vacancy remains tight

A more detailed examination of rental data from the New South Wales Department of Housing highlights the general moderation in the rate of increase in median rents during 2009. At the September quarter 2009, the median rent for a three-bedroom house in Sydney sat at \$350 per week, up by just \$10 per week since the March quarter. The median rent for two-bedroom units sat at \$400 per week, unchanged since the start of 2009. The overall Sydney vacancy rate at the September quarter was 1.3%, according to the Real Estate Institute of Australia. Sydney's vacancy rate has remained tight at around this level since the end of 2006. Later data from the Real Estate Institute of New South Wales shows a slight increase in the vacancy rate, to 1.6%, at November 2009. By precinct, Outer Sydney (greater than 25km from the CBD) recorded the lowest vacancy rate, at just 1.1%. Inner Sydney (within 10km of the CBD) recorded a vacancy rate of 1.5% with Middle Sydney (between 10km and 25km from the CBD) recording the highest vacancy rate at 2.3%.

Capital Growth and Sales Volume Newcastle Houses

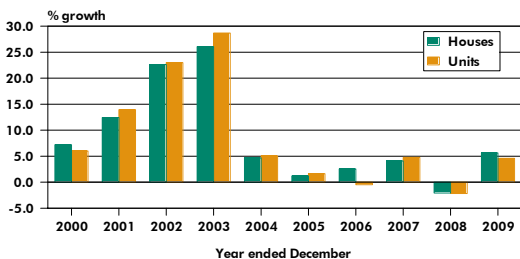


Source : Residex (December Quarter 2009)

Newcastle reflects Sydney trends

The Newcastle (Residex region postcodes 2264 to 2319) house market in 2009 appears to have largely reflected the same trends evident in the Sydney market. The annual sales volume, at 6,822 sales, was 28.6% higher than the 2008 total and the highest annual tally since 2003. With the median value in the December quarter at \$380,000, an annual increase of 8.4% was recorded, compared with the previous years decline of 3.0%. Again, the annual value increase was the strongest to occur since 2003. The median rent at the December quarter was \$345 per week, generating a rental yield of 4.74%. This was little different to the previous years, but was noticeably stronger than the yields, often sub-4.0%, that had been generated in the preceding six years.

Annual Capital Growth Houses & Units, Country New South Wales



Source : Residex (December Quarter 2009)

New South Wales country capital value growth positive

After a decline in 2008, the median value of both houses and units in country New South Wales also recorded modest increases in 2009 according to Residex. The median value of country houses at the December quarter 2009 was \$328,000, with growth of 5.7% generated over the year. Country units recorded a median value of \$292,500, with annual growth at 4.6%. For houses, the growth figure was the strongest evident since 2003, while for units, the result was similar to that seen in 2007, although both were much lower than the 2003 market peak. Sales volumes across both markets recovered in 2009 with the number of house sales at 47,479 (22.6% higher than 2008) and the number of unit sales at 12,411 (26.7% higher than 2008). A median house rent of \$310 per week was recorded in the December quarter, generating a rental yield of 4.93%. Units recorded a median rent of \$260 per week with a rental yield of 4.64% generated. Yields were at their highest level in six years for houses and seven years for units.

Market Outlook

With the Federal Government's First Home Owner's Grant having returned to its pre-boost levels and three consecutive interest rate rises from October to December 2009, conditions have been set for a mixed and challenging 2010 for the residential sector.

The Reserve Bank of Australia (RBA) surprised most by leaving the official cash rate unchanged at 3.75% at their February 2010 Board meeting, This was their first meeting of 2010.

In the statement released subsequent to the Board meeting, the RBA highlighted the fact that Australian economic conditions have been stronger than expected. While the effects of the fiscal stimulus on consumer demand has now faded, household finances are being supported by strong labour market conditions and a recovery in net worth. Credit for housing has been expanding at a solid pace and dwelling prices have risen significantly over the past year.

Importantly, the statement identified that interest rates to most borrowers remained lower than average. If economic conditions evolve broadly as expected, it is likely that monetary policy will be adjusted further to ensure that inflation remains consistent with the medium term target.

In short, expect further rises to the cash rate over 2010. Most analysts are still suggesting that the official cash rate will return to a more neutral setting of between 5.00% and 5.75% by the end of 2010.

The New South Wales residential market ended the year very strongly in 2009, with residual market activity flowing into January 2010.

First home buyers appear to be leaving the market, but the slack has been picked up to some degree by investors particularly in the medium price range. The 50 per cent stamp duty cut for newly-built homes worth less than \$600,000, introduced by the State government in mid-2009, has been extended from December 31, 2009 to June 30, 2010. This is likely to help sustain investment demand in the first half of 2010.

At this stage, the interest rate rises are yet to have any tangible affect on the market, with sales activity strengthening and anecdotally the strongest in the western suburbs of Sydney (the traditional mortgage belt). Given New South Wales is particularly susceptible to interest rate changes due to the high median house price further rises are likely to test the market as 2010 progresses.

In terms of the rental market the main issue for New South Wales is housing supply. This lack of supply is pushing up both house prices and in turn rental levels. With population growth forecast to continue at reasonably strong levels over the short to medium term the competition among investors and renters is therefore likely to intensify pushing up prices and rents further over the short term.

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