

NATIONAL PROPERTY SECTOR REVIEW 2008

INDEPENDENT ASSESSMENT

This report has been prepared for financial advisers only

Report Date: 31st January 2008

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Welcome to the 2008 National property market update.

2007 will be remembered particularly for the last quarter as global equities and real estate investment trusts sharply corrected. And as we go to publication, they are still correcting.

Here in Australia, the ASX S&P 300 Property Trust Index is now down by over 30% from its peak. It is the sharpest correction seen for listed property trusts (LPTs) since the recession of 1989/91.

For listed property fund managers there truly has been no where to hide with many in the market place mandated to hold a maximum cash level of no more than 5%.

Still, the best fund managers have managed returns superior to that of the index by staying out of the Centro and MFS collapses. They have done this by simply conducting in-depth research and avoiding those managers where there have been questions over corporate governance. In our opinion the problems at Centro were foreseeable and that is why some managers were able to avoid the iceberg, while others ploughed straight into it.

In turn, the large scale correction may be offering opportunities not seen in the market place for many years. Distribution yields on a number of trusts are now over 10% while some (with no apparent financing issues) are offering yields as high as 15%.

Certainly, compared to direct property, the yields in the LPT market are significantly more attractive. But will direct property yields now rise to compensate?

While indexed adjusted bond yields suggest there won't be a blow out in capitalisation rates for direct property, yields on the LPT market suggest there are some large problems on the horizon for commercial property, which intuitively makes sense. Rising cost of capital combined with potentially slower tenant demand will deter many would be commercial property buyers. Still, we believe that the Australian economy will remain stable but subdued, providing positive returns for the next 12 months.

Recent data suggests Australian east coast residential has performed notably in 2007. Our forecast that Sydney houses would rise by 10.5% during 2007 was close, however a touch optimistic. Based on recent preliminary data to the month of November, Sydney house prices rose by 9.6% on an annualised basis.

Performance in Perth however has been lacklustre by comparison, with prices flat lining in 2007. Had base and precious metal prices not held their ground, it is likely that capital growth would have been negative. Our forecast for 2008 is a similarly flat market, again with substantial dependence on metal prices. Should there be a sustained collapse in hard

commodity prices it is likely that Perth housing prices will fall hard, with a steep 20% or more decline not out of the question.

2008 is likely to be yet another year of higher east coast house prices. While the RBA has been lifting rates, injections to help provide liquidity to the credit markets and stimulus by the Commonwealth government have meant there is more money than ever circulating in the economy. The M3 measure of money supply is now growing at over 23% per annum, its highest rate since 1989.

As occurred with our 2007 report, our research team has independently dissected the data to provide a complete and detailed overview of the Australian property market for residential, commercial and listed property trusts.

We hope you enjoy the report.

Louis Christopher
Head of Property Research
Adviser Edge



The primary source of data used in this report came from the following sources:

- Property Council of Australia;
- Commercial Property Monitors Pty Ltd;
- CB Richard Ellis;
- Australian Bureau of Statistics;
- Bloomberg News;
- Australian Property Monitors; and
- SQM Research.

As in the residential property market, reliable and timely data is often hard to come by in the commercial property markets. The statistics on the direct property market featured in this report often have lags for the most recent period reported and are subject to revision.

Further, due to the relatively small number of transactions that occur in the commercial property market, it is not possible to measure with confidence smaller geographical areas. Indeed, even some cities cannot be measured with great accuracy simply due to the small number of transactions in the market place.

Where there has been significant doubt on the results, we have decided to not include the statistics.

Subsequently this report has focused on a macro view with regard to geographical coverage to ensure that as much data as possible is included to draw up the statistics.

Adviser Edge notes that some discrepancies may be displayed in the relationships between the recorded figures for rental growth, yields and capital growth. This is due to a combination of factors, as outlined below:

- Capital value growth is transaction based. As sale prices are generally factored on existing rent and reversion, capital growth may outstrip that expected from that period's rental growth.
- The growth in market rentals is based on new leases, not reviews of existing rents.
- Furthermore, time lags and a lack of homogeneity cloud the data further.

As a consequence, the figures shown in the tables in this report provide an overview of the situation rather than a precise metric.

The deficiencies in the data are no fault of the data providers themselves. Simply, it is the nature of industry and the Valuer General delays in final reporting as well as the small number of transactions that occur in the commercial property markets that make compiling reliable statistics a difficult process.

Nevertheless, in the tradition of Adviser Edge, this is an independent report that aims to inform the reader of the current state of the property market, both commercial and residential as well as its likely movements over the next two years including an update on the Australian LPT market.

Global Credit Crisis

The sub prime mortgage crisis, which originated in the United States, has caused major panic throughout the global financial markets. The fallout is expected to continue into 2008 and even 2009, as ticking credit bombs continue to explode internationally. Australia has not been immune to the effects of this crisis. Lending has become more stringent, rates are increasing, and some very well known mortgage and property institutional scalps have been claimed.

Office Markets Maintain Momentum

The CBD office market is likely to be the best performing sector in 2008, based on current falling vacancy rates and a rise in market rents above the CPI. However, the key fundamentals of location and quality will become increasingly important for maintaining returns as market conditions begin to cool towards the end of the year.

Industrial Prospects

Although industrial has been a strong performer in 2007, the sector is expected to slow in 2008 due to growing unease over the state of the Australian economy. This will be evidenced in decelerating rental growth and yield softening. The decline of the industrial sector is expected to take full effect in 2–3 years time.

Sydney Residential in Recovery

Sydney residential is entering into its second year of upswing. Meanwhile Perth is likely to record house price declines this year. The surprise performer has been Melbourne, which has had a boom in 2007. However, additional interest rate rises and/or higher unemployment may stop the upswing in its tracks.

Listed Property Trusts

Listed property trusts around the world have crashed during December and January on fears of a global economic downturn and a response to a number of very large Listed Trusts on the verge of bankruptcy. On a forward earnings multiple the domestic LPT market now appears quite cheap. However, a global downturn, if eventuated would mean there would be more falls to come.

The Growth of Green

Sustainability in both building design and operation has received increased consideration in 2007. This is being driven not only by public awareness of the effect of commercial buildings on climate change, but also a growing realisation of the link between environmental and economic sustainability.

Key Economic Assumptions Behind Forecasts					
Macroeconomic Indicators	Calendar Year Averages				
	2005	2006	2007 (p)	2008 (f)	2009 (f)
World GDP (real)	4.9	4.8	4.7	3.5	3.8
Australia GDP (real)	2.8	2.4	4.2	3.0	3.2
US GDP (real)	3.2	3.3	2.1	1.2	1.5
Australia					
Retail Trade (nominal)	3.2	6.5	8.0	5.0	6.5
Unemployment Rate	5.1	4.9	4.6	5.1	5.3
10-year CGS Bond Yield	5.3	5.6	6.3	6.3	6.4
Index-Linked CGS Bond Yield	2.6	2.3	2.5	2.6	2.7
Employment Growth	3.1	2.0	1.7	1.3	1.2
Australian Cash Rate	5.5	5.8	6.8	7.0	6.8
Non Residential Building Approvals	21.1	2.8	1.5	-5.0	2.0
Non Residential Construction	17.4	12.8	1.1	2.0	-3.0
Housing Finance	11.3	2.6	5.0	-2.0	5.0
Commodity prices (RBA)	33.6	10.7	-0.2	-9.0	0.0
CPI					
Australia – Headline	2.7	3.3	3.0 ¹	3.3	3.0
World	3.9	3.9	3.6	4.0	3.9

Source: Adviser Edge, Van Eyk Research, ABS Cat 6202, 8731, RBA ¹ Actual

GDP

GDP to December 2007 is running higher than originally expected at around 4.2%. The positive result was due to a combination of factors including the fact that terms of trade has held up, commodities did not level-off as expected and robust consumer spending continued despite two interest rate rises.

The outlook for 2008, however, is less optimistic. Although our economy has become more dependent on Asia and less on the US, Australia and indeed the rest of the world will not be immune to the recession expected in the US, as the effects of the credit crisis have clearly spread out across the globe.

The RBA rate rises of last year as well as increases in bank lending rates independently of any reserve bank rate changes will cause consumers to struggle with higher debt servicing payments in 2008, despite tax cuts.

Based on the above, our forecast is for domestic GDP to drop to around 3.0% for 2008. The risk to the forecast is on the downside rather than the upside.

Retail Sales

The rate of growth in retail is expected to be 7.3% to December 2007, on par with our predictions from our April 2007 report. This is still below the high results of 13%–14% p.a. recorded earlier in the current decade but remains above the CPI.

As also observed in 2006, retail sales for the year to December 2007 have been stronger in the resources states of Western Australia and Queensland. Although wages growth in 2008 is still expected to be reasonable, debt levels are high and interest rates are expected to rise. As a result, our forecast is for nominal retail sales to slow further to an annual rate of 5% for 2008.

CPI

Annual headline CPI to the end of December 2007 was 3.0%. A CPI increase of just 1.9% was recorded in the year to September, showing the majority of the CPI increase for the year has occurred in the final quarter. This can be attributed in part to retail growth and petrol prices.

Looking ahead, the tax cuts promised by the recently elected Labor Government will continue to add to inflationary pressures, although recent media announcements also suggest that the new Government may run a strong budget surplus for 2008.

Based on the above, our forecast is for the headline CPI rate to increase to 3.3% for 2008.

Building Approvals

Total dwelling unit approvals rose by a modest 1.5% for the year to November 2007. Victoria and NSW recorded approvals rising by around 2% each while QLD recorded a slight decline for the year. Approvals for WA were higher at around 8% on average for the year to November 2007.

Our forecast for 2008 is for building approvals to fall by 5% with falls driven by Western Australia and Queensland. NSW is expected to record a rise in building approvals.

Housing Finance

The number of housing finance commitments rose slightly during the year to November 2007 by about 3.8%. The modest rise was driven by large increases in Victoria and Tasmania and smaller increases in other states. Housing finance commitments in WA remained relatively flat in 2007 after reaching a record high in 2006. The annual rate for Australia is now trending up by a marginal 2% p.a. and our forecast is for housing finance to fall in 2008 by about 2% p.a.

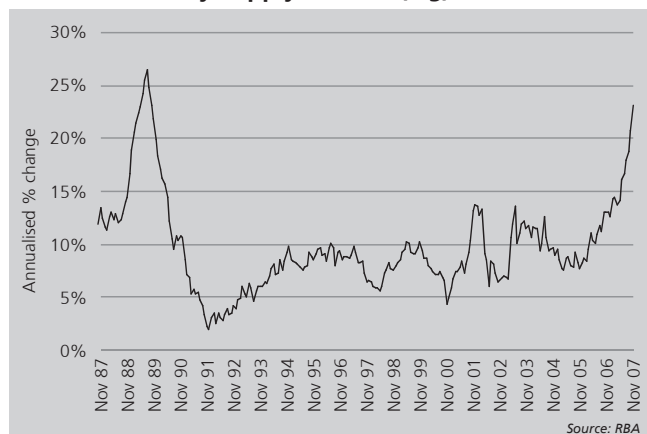
Employment Growth and Wages

Employment growth annualised as at the end of December 2007 is expected to be around 1.7% which has dropped from the previous two years. Unemployment tending towards 4.6% for the end of December 2007 is at a 30-year low with many reports from various industries struggling to find labour. Our forecast is for unemployment to rise to 5% for 2008 as the domestic and US economies slow.

Money Supply

Since our last report the Australian Money supply (M3) continued its rapid growth to reach an annualised rate of just over 23% to the month of November 2007, the highest level recorded in 18 years. Historically, rapid increases in money supply growth have been highly correlated with house price bubbles.

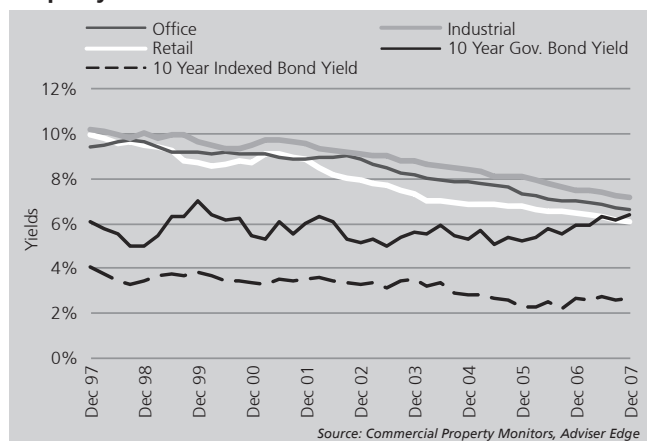
Australian Money Supply Growth (M3)



Yield Convergence

2007 recorded an acceleration of the long standing convergence between Property Yields and 10-year government bond yields. Properties yield compression has been driven by rising capital growth outstripping rental growth. The relationship has now reached a historic first, with 10-year government bond yields outstripping direct retail property. However, the yield differential between indexed bonds and property has remained relatively constant. This would suggest property is still properly priced on the basis of income expectations. That said, a lack of demand may place upward pressure on property yields going forward.

Property Yields versus 10-Year Bond Yield



Property View									
Coverage									
Asset Class	Overall	Sydney	Melbourne	Brisbane	Perth	Adelaide	Canberra	Darwin	Hobart
Office	Overweight	Overweight	Overweight	Overweight	Underweight	Overweight	Neutral	Underweight	Neutral
Industrial	Neutral	Neutral	Overweight	Neutral	Neutral	Overweight	Neutral	Neutral	Neutral
Retail	Neutral	Neutral	Underweight	Neutral	Underweight	Overweight	Overweight	Neutral	Neutral
Tourism & Leisure (Hotels)	Overweight	Overweight	Overweight	Overweight	Neutral	Overweight	Overweight	Neutral	Neutral
All Commercial	Overweight	Overweight	Overweight	Overweight	Underweight	Overweight	Overweight	Neutral	Neutral
Residential	Neutral	Overweight	Overweight	Neutral	Underweight	Overweight	Neutral	Underweight	Neutral

Key:

Underweight – Expected total returns to be under 10%

Neutral – Expected returns to be between 10%–15%

Overweight – Expected returns to be over 15%

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House prices (Median)	Dec Qtr 2007 (Est)	Dec Qtr 2007 Change (Est)	Year to Dec 2007 Change (Est)	CAGR* to Dec 2007 (Est)	Forecast 2008	Forecast 2009
Sydney	\$572,685	4.4%	9.5%	8.4%	12%	6%
Melbourne	\$436,950	0.4%	22.1%	9.6%	15%	10%
Brisbane	\$407,890	2.0%	17.9%	8.2%	9%	12%
Adelaide	\$363,875	1.2%	12.7%	7.6%	10%	11%
Perth	\$514,517	0.8%	3.9%	10.8%	4%	5%
Canberra	\$486,040	0.2%	16.0%	7.4%	10%	8%
Hobart	\$258,400	0.5%	9.5%	N/A	5%	6%
Darwin	\$421,050	0.0%	4.7%	N/A	3%	4%
National	\$432,676	1.2%	12.0%	8.7%	9%	8%
Unit prices (Median)	Dec Qtr 2007 (Est)	Dec Qtr 2007 Change (Est)	Year to Dec 2007 Change (Est)	CAGR* to Dec 2007 (Est)	Forecast 2008	Forecast 2009
Sydney	\$367,500	0.9%	5.0%	6.3%	13%	5%
Melbourne	\$319,062	0.8%	17.3%	7.3%	12%	9%
Brisbane	\$313,300	0.2%	16.5%	6.6%	8%	10%
Adelaide	\$246,297	1.5%	14.6%	7.3%	11%	12%
Perth	\$350,079	1.0%	0.3%	10.2%	3%	4%
Canberra	\$347,770	2.4%	12.2%	6.6%	7%	6%
Hobart	N/A	N/A	N/A	N/A	2%	5%
Darwin	\$310,272	2.3%	8.1%	N/A	4%	5%
National	\$322,040	1.3%	10.6%	7.4%	8%	7%

* Compounded Annual Growth Rate of Median Property Prices
Source: SQM Research, APM, REIA

It is now apparent that from the 2nd half of 2006 a general housing recovery was underway on the east coast of Australia. Notably, auction clearance rates have been significantly higher in Sydney, Brisbane, Canberra, Adelaide and Melbourne compared to the 2004-2006 downturn.

Indeed, it appears that in the second half of 2007, east coast house prices were accelerating as measured by the Rismark-RP Data Hedonic Index, taken to November 2007.

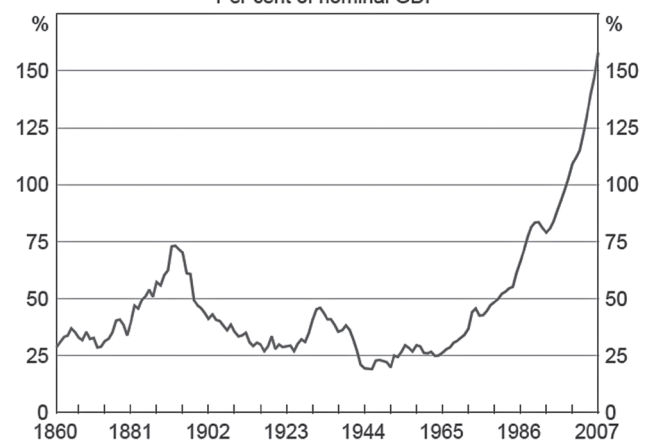
Despite the three rate rises of 2006 followed by another two in 2007 and the sub prime crises in the US, the residential market in most of metropolitan Australia is strong. How is this so?

In our April 2007 report we suggested that this was probably due to a combination of factors including rising rents, improving relative affordability and wages growth. Underlying all this however was the rapid increase in domestic money supply (M3), which was running at 15% (at the time) as reported by the Reserve Bank of Australia.

Since our last report the Australian Money supply (M3) continued its rapid growth to reach an annualised rate of just

over 23% to the month of November 2007, the highest level recorded in 18 years. Given that a rapid increase in money supply growth has been highly correlated with house price bubbles in the past (particularly between 1988-1990), does this mean we are experiencing a new 'bubble' in house prices?

Credit – Australia*
Per cent of nominal GDP



* Before 1953, the series relates only to the credit provided by banks, after that it includes credit provided by all intermediaries.
Sources: ABS; RBA

Credit has grown on average about 5% a year faster than nominal GDP between 1997 and 2007. It is a matter of arithmetic that if credit is growing faster than GDP, then the ratio of credit outstanding to GDP will rise. The extent of the upward trend in this ratio, and its persistence over such an extended period, is unusual, if not unprecedented.

In short, deregulation, innovation and lower inflation have simultaneously increased the supply, and reduced the cost, of finance to households, and not surprisingly households have responded by increasing their use of it. Household credit outstanding rose from 20% of GDP in the 1970s to 30% by 1990, and to around 100% today. Household credit accounted for the bulk – 85% – of the rise in overall credit to GDP over the past 15 years, and household credit now greatly exceeds business credit in terms of outstandings.

The point illustrated is that access and use of credit by Australian households has occurred at unprecedented levels, which has fuelled house price increases in recent years.

At a macro level, the evidence appears to suggest a new bubble is taking place, especially given where affordability and debt measures are now at. However there does appear to be mitigating circumstances at the state level. For example there is currently a genuine gap between underlying demand and supply levels of housing in NSW.

As mentioned in our April 2007 report, we have the situation over the last few years where different states are revealing a completely different picture. The new east coast upswing is in stark contrast to the downturn experienced in Western Australia and Northern Territory where the real estate bubble is slowly deflating.

Housing finance for Western Australia is still 16% below its peak in June 2006 (as at November 2007) while the Northern Territory has fallen by 19% over the same period. House prices have also been largely flat to negative.

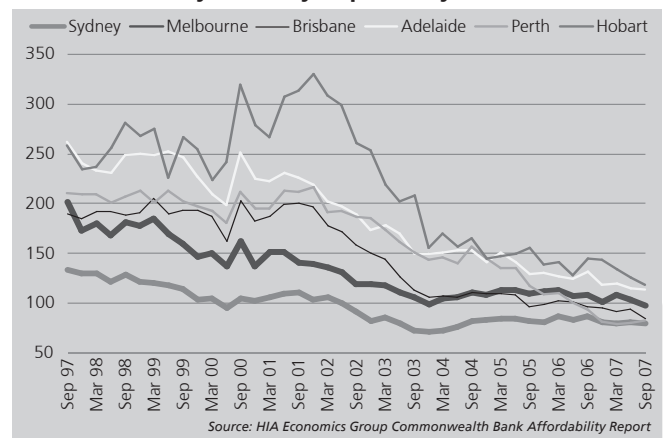
However, while this downturn for the resource states is clearly occurring, it may be short-lived if commodity prices continue upwards. That is of course a BIG 'if' given the current global economic outlook.

Affordability Deteriorating

In our last report we noted that housing affordability is now at record low levels. Is housing in Australia overvalued?

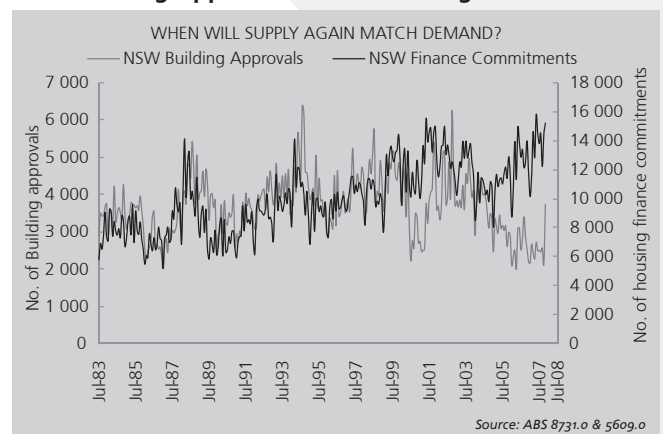
Certainly there has been declining affordability in many states over recent years driven by the increase in wages, but notably the loosening of credit as displayed via money aggregates M3.

HIA Affordability Index by Capital City



The dislocation between demand and supply is also a factor, especially in NSW.

NSW Building Approvals versus Housing Finance



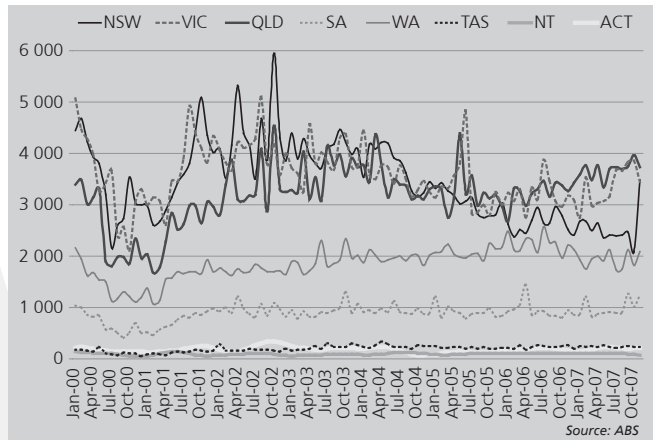
The chart reveals that while NSW building approvals are just coming off an all time low, NSW housing finance is near an all time high. How is it possible that there is rising housing demand yet, until recently, falling supply? Will this last?

The answer may lie in unit and land prices, in that while demand has risen in recent times, price hasn't yet caught up. Developers require unit prices to be at a certain levels in order to generate a profit from the development.

NSW unit prices are just now catching up to where they were back in late 2003 – the point at which building approvals peaked. So developers have been slow in this cycle to meet demand, however given our forecasts over the next 12 months for median unit prices, we do expect a response from supply and indeed this may be coming through now.

This has also been a similar story for other states including Queensland and to a lesser extent Victoria.

Building Approvals by State (To November 2007)



Sydney

Sydney is showing healthy signs of a recovery after a time of stagnant growth after the last boom abruptly ended with two successive rate rises in 2003.

Sydney’s median house price as reported by Australian Property Monitors (APM) rose during the September quarter by 2.9%, taking the 12-month change to September 2007 to 4.6%.

RP Data’s hedonic Index suggests an accelerated increase throughout the December quarter of 2007, with median house price expected to be approximately 9.6% for the year.

Auction clearance rates were consistently above 60% in the later months of 2007 compared to 50% over the same period in 2006, which is a strong leading indicator that a recovery has been underway.

In the last report we anticipated price rises for Sydney in 2007 were in the order of 10.5%. As mentioned, it is likely that the calendar year 2007 result will be modestly under this forecast. Our forecast assumed a stable interest rate environment for the duration of 2007 however this was not to be.

In addition, we underestimated how deep the downturn was in Sydney’s west and how much more sensitive that region has become to interest rate rises.

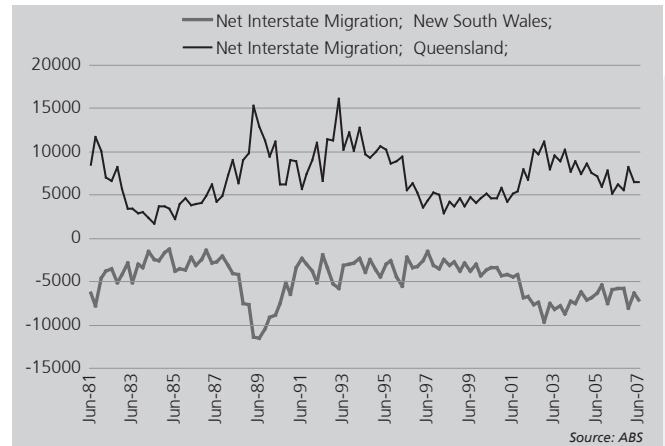
However, it is interesting to note also that in a number of inner suburban regions in Sydney house price growth has now grown beyond 10% and we believe this rate of growth will continue in 2008 as share market investors look for other investments.

We expect Sydney median house prices to grow at around 12% in 2008 and then 5%–6% in 2009. It is possible that 2009 may prove stronger than expected if there is an inflation breakout.

Improving Affordability for Sydney

Contrary to Sydney, Brisbane’s relative affordability has dropped, causing a reduction in net interstate migration away from Sydney. The graph shows net interstate migration into New South Wales and Queensland are almost mirror images of each other.

Net Interstate Migration (To June 2007)

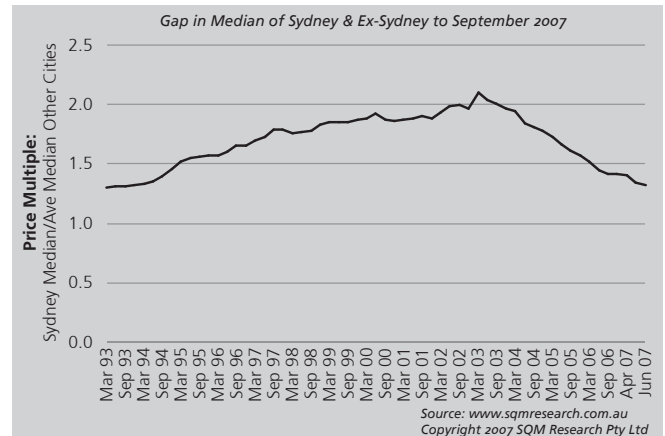


Last time we showed a graph of the ‘Average Price Gap’ of Sydney versus other cities and noted that the price gap had reduced from 2002 where Sydney prices were twice that of other states to only 20% higher in recent months.

Over the last decade, people have been moving away from Sydney and into Brisbane and other states where housing is more affordable. In March 2003, Sydney house prices were more than twice that of the other cities.

However coinciding with the end of the property boom in 2003 when the resource cities of Brisbane and Perth just kept on going, the gap between Sydney and prices in other states has dropped back to be only 30% higher in September 2007.

Sydney Price Gap



Could we see less people moving from Sydney to Brisbane in future, as relative affordability in Brisbane continues to decline?

Clearly recent population trends suggest net interstate migration to Queensland has slowed and is likely to continue to slow while the standard of living gap between the southern states is minimal.

Mortgage Stress in Sydney's West

Although Sydney overall is in recovery, there are pockets where the reverse is true, depending on which demographic of Sydney you are looking at.

Recent media has paid much attention to the sub prime mortgage crisis currently affecting the US, with interest as to what extent the problem is occurring here.

In our last report we mentioned the problems in Sydney's west and noted the increased repossessions reported by agents on the ground. As now confirmed by the Reserve Bank of Australia this is one area that is experiencing a higher than average level of 'mortgage stress'.

The section on the sub prime mortgage crisis at the end of this article depicts graphs which show the western suburbs of Sydney as being over-represented in the number of writs and possessions by region for 2006.

Rents Still on the Rise

According to the Real Estate Institute of Australia, vacancy rates have tightened in the September Quarter in most cities.

Vacancy rates no higher than 1.6% at the end of September were recorded for Sydney, Melbourne, Brisbane, Adelaide and Darwin.

Vacancy Rates: September 2007 & June 2007		
Capital City	September 2007	June 2007
Sydney	1.40%	1.40%
Melbourne	1.20%	1.40%
Brisbane	1.60%	1.50%
Adelaide	1.50%	1.30%
Perth	2.50%	2.10%
Canberra	2.20%	2.40%
Hobart	2.20%	2.30%
Darwin	0.70%	1.20%
Average	1.66%	1.70%

Source: REIA

As a result, this has and will continue to put upward pressure on average weekly rents given construction activities are not expected to be meeting demand going forward.

The resource states of Darwin, Perth and Brisbane recorded massive increases in rentals for 3-bedroom houses for the year

to September 2007. Darwin recorded a massive 44% increase for the year while Perth and Brisbane each recorded increases of around 15% for the year.

The fact that no state recorded rental increases for houses lower than 8% is indicative of the tight rental market over the year.

3 Bedroom Houses						
Rentals	September Quarter Estimate	Quarter Change	1 Year Change	Gross Yield	Forecast 2008	Forecast 2009
Sydney	\$295	5.36%	9.26%	2.8%	10.0%	8.0%
Melbourne	\$260	4.00%	10.64%	3.1%	9.0%	8.0%
Brisbane	\$300	3.45%	15.38%	3.9%	10.0%	10.0%
Adelaide	\$255	2.00%	8.51%	3.7%	9.0%	7.0%
Perth	\$300	0.00%	15.38%	3.1%	10.0%	12.0%
Canberra	\$350	0.00%	9.38%	3.8%	6.0%	5.0%
Hobart	\$270	0.00%	8.00%	5.5%	5.0%	5.0%
Darwin	\$440	11.39%	44.26%	5.4%	12.0%	11.0%

Source: REIA Adviser Edge

2-Bedroom Other Dwellings						
Rentals	September Quarter Estimate	Quarter Change	1 Year Change	Gross Yield	Forecast 2008	Forecast 2009
Sydney	\$340	3.0%	9.7%	4.9%	11.0%	8.0%
Melbourne	\$270	3.8%	12.5%	4.4%	10.0%	9.0%
Brisbane	\$290	3.6%	11.5%	4.8%	7.0%	7.0%
Adelaide	\$205	2.5%	7.9%	4.4%	8.0%	7.0%
Perth	\$290	3.6%	20.8%	4.3%	12.0%	12.0%
Canberra	\$340	3.0%	13.3%	5.2%	7.0%	6.0%
Hobart	\$230	9.5%	15.0%	snr	6.0%	5.0%
Darwin	\$340	13.3%	51.1%	5.8%	12.0%	10.0%

Source: REIA Adviser Edge

Melbourne

Melbourne is now approximately 24 months into its housing recovery and in a rising market, in fact booming. According to APM, prices have risen over the last year to September 2007 by over 19% with the majority of this occurring in the 3rd quarter of 2007 which jumped 9.6% and looks like continuing on till the end of 2007.

Sales activity has continued to grow with the number of properties sold at auction more than doubling in the 12 months to September 2007 according to the Australian Property Monitors.

Auction clearance rates have jumped from 57% in September 2006 to 81% in September 2007, according to the Australian Property Monitors. However, it must be noted that the underlying source of this figure may not be as reliable as that for other cities.

Strong population growth driven by high overseas migration compared to other cities, and increasingly low vacancy rates in Melbourne have put pressure on both house and unit prices.

Our forecast is that Melbourne house prices are likely to continue rising but at slightly lower levels of around 15% for the course of 2008 and depending on movements in interest rates, are likely to be around 10% to 12% in 2009.

Brisbane

Brisbane house prices recorded very strong growth rates of around 17% over the past 12 months to September 2007. While net interstate migration levels to Queensland have slowed, possibly due to declining affordability relative to Sydney, international migration has increased and there is still a shortage of supply, maintaining upward pressure on prices.

The rental market is tight with vacancies at 1.6% at September 2007, representing a drop from 12 months prior.

Median house price predictions for 2008 have been revised upward to be around 8% and then 10% in 2009.

Long term, we believe the current rates of growth for Brisbane are not sustainable, and are at risk of recording house price falls if there was a sustained economic downturn.

Perth

The downturn in the Perth housing market continues albeit at a softer rate than what was predicted earlier in 2007 due to better than expected commodity price level. The median price for the September quarter increased by 1.3% for houses and dropped

1.1% for units. Housing finance fell 7% for the 12 months to June 2007.

Going forward we still expect Perth house prices to grow albeit at relatively low levels of about 4% in 2008. The risk is on the down side if there is a sustained downturn in demand for hard commodities.

Perth will also remain particularly sensitive to any potential interest rate rises

Canberra

Similar to Melbourne, Canberra is in a rising market being two years into recovery after the 2004-05 downturn. However, the recovery in Canberra's residential property prices which reached almost 18% over the past 12 months to September 2007 occurred earlier than the Melbourne recovery, with the recent quarter in September slowing, recording less than a 2% increase.

The tight rental market is one of the main underlying drivers of the increase with vacancy rates still at around 2% and very strong demand for new housing.

Going forward given the prospect of rising interest rates, the predictions for 2008 and 2009 are lower at around 12% and then 8% respectively.

Hobart

Hobart has slowed considerably relative to the high rises over the 2003–2005 period, with an increase of only 3.1% for the 12 months to September 2007. Rental vacancy rates still remain low at around 2% and the trend in new house construction is decreasing.

Given that there is still a shortage of supply, and that Hobart continues to be the most affordable city, price growth is predicted in the 2008 and 2009 years of around 5% and 6% respectively.

Concerns around interstate migration away from Hobart and the higher level of unemployment in Tasmania remain, particularly in the light of a predicted slowdown in the US and to a lesser extent China in the next year.

Adelaide

After Adelaide's soft landing with annual house price growth slowing to a rate of 6%, it has had a recent surge in house prices with over a 10% increase in the year to September 2007 with the majority of this increase being seen in the June quarter.

Auction clearance rates (although the numbers are small) have jumped from 62% to 77% for the 12 months to September 2007.

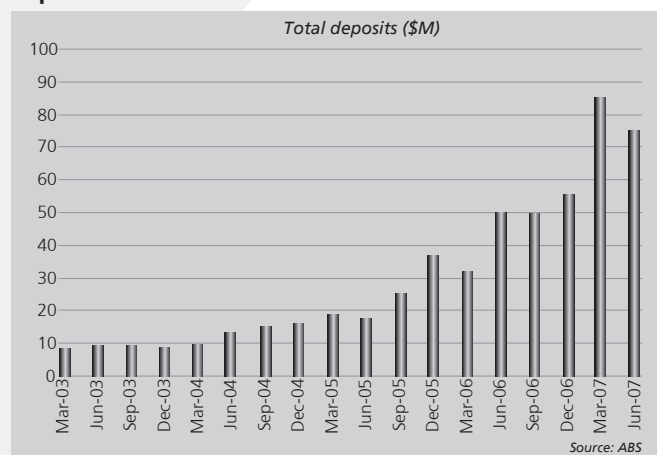
It is interesting to note that median units have jumped by around 14% to September 2007; however Adelaide median unit prices have been historically volatile due to the increase in new dwelling construction, in the CBD rather than an inherent price increase in existing, older style units and land values.

Although affordability has decreased in Adelaide, it is still very affordable in comparison to other capital cities and as a result is likely to see continued strong price growth in 2008 in the order of 10%.

Overall price increase have occurred due to an increase in demand for labour, particularly stemming from the commodities boom

The chart below shows the increasing trend in expenditure on mining exploration in South Australia, especially over the past two years.

Expenditure – South Australia



Darwin

In our April 2007 report we mentioned that Darwin house prices have skyrocketed from December 2003 to June 2007, almost doubling during the 3.5 years. We noted underlying factors including the commodities boom, the rail link and low unemployment.

However, similar to the story for Perth, the huge and rapid increase in prices without a similar growth in wages has meant that affordability has now reached a low.

The year to September saw very modest price growth for Darwin at 2.8% which includes a quarter of negative growth in September.

Darwin seems to have reached a peak to the recent cycle and going forward will be sensitive to interest rate rises and unemployment. The predictions for 2008 and 2009 therefore, are more subdued at around 3% and 4% respectively.

However, the rental market is very tight with the vacancy rate dropping to just 0.7% for September 2007, rent increases for houses and units over 30% in the 12 months to June 2007 and more increases expected to follow in 2008 and 2009.

Office Sector	Periods Ending December 2007 (Compounded)				Forecast Data		
	1 Year ¹	3-year	5-year	10-year	2008	2009	Dec 07 Qtr
Rental Growth							
NSW	15.5%	1.2%	3.0%	3.2%	6.4%	4.1%	2.6%
VIC	8.4%	1.3%	2.1%	6.0%	5.3%	4.8%	1.8%
QLD	40.5%	21.9%	17.0%	11.1%	10.8%	-6.0%	6.2%
Composite	23.9%	9.0%	7.9%	6.9%	8.2%	-0.5%	4.1%
Capital Value Growth							
NSW	15.2%	8.5%	8.0%	7.5%	10.2%	6.4%	4.1%
VIC	10.2%	8.6%	8.9%	9.7%	9.5%	9.5%	5.7%
QLD	22.9%	17.7%	17.9%	11.1%	9.7%	4.7%	6.4%
Composite	16.1%	11.2%	11.0%	9.2%	9.8%	6.7%	5.3%
Yield²							
NSW	7.0%	7.2%	7.4%	8.1%	7.1%	7.2%	
VIC	6.6%	6.9%	7.3%	8.1%	6.7%	6.9%	
QLD	6.8%	7.4%	8.0%	8.9%	7.0%	7.2%	
Composite	6.8%	7.2%	7.6%	8.4%	6.9%	7.1%	
Total Return							
NSW	22.2%	15.7%	15.4%	15.6%	17.3%	13.6%	
VIC	16.8%	15.6%	16.2%	17.7%	16.2%	16.4%	
QLD	29.7%	25.1%	26.0%	20.1%	16.7%	11.9%	
Composite	22.9%	18.4%	18.5%	17.5%	16.7%	13.8%	

Source: CPM Research Data, based on quarterly \$/sqm rental and capital value figures

¹ Includes partial forecast data ² Average (non-compounding) data presented

2007 has been a very positive year for investors who have had an exposure to the national direct office market. The momentum established in 2006 has continued, with vacancies tightening, rents rising and office yields falling.

Total estimated returns for the Office market for 2007 came in at 22.9% nationwide. The drivers of the office market have included:

- strong employment growth, thereby creating an increase in demand from tenants;
- minimal increases in supply underlying solid absorption rates and in turn reducing vacancy rates; and
- strong institutional demand by property trusts and developers creating rises in capital values and a tightening in yields.

Australia has been correlated to the performance of global office markets for some time now. Therefore, it is not surprising that the out performance of the national office market in 2007 has occurred in a favourable international environment, with an above long term average rise in world gross domestic product and continued demand from global REITS for premium commercial property.

That said, there has been some difference in the performance of the office market between Australia's three eastern seaboard states. Queensland recorded total returns in excess of 29%, slightly above the New South Wales figure of approximately 22%, while Victoria recorded total returns under 17%. The strong performance of Queensland and NSW is believed to be a result of their burgeoning demand for corporate and professional services, coupled with a restricted inventory of office space.

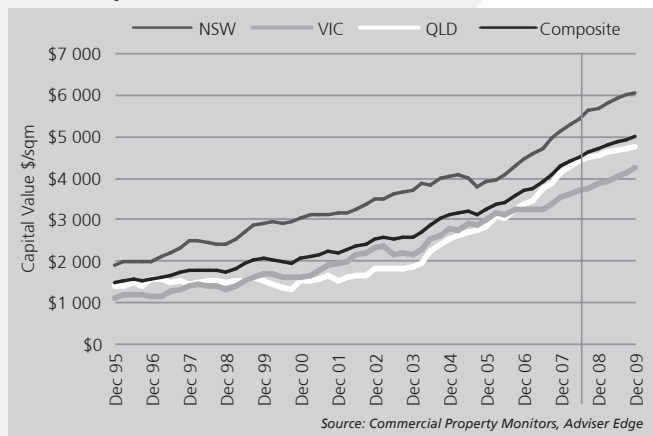
Office Capital Values, Vacancies, Yields and Rents

According to Data from Commercial Property Monitors, average capital values across Australia's eastern seaboard office markets have increased by 16.1 % for 2007. This increase in values is up on 2006 where average CBD capital values rose by 14.5%.

Queensland again recorded the highest growth rate of 22.9%, while Victoria recorded a rise in capital values of 10.2%.

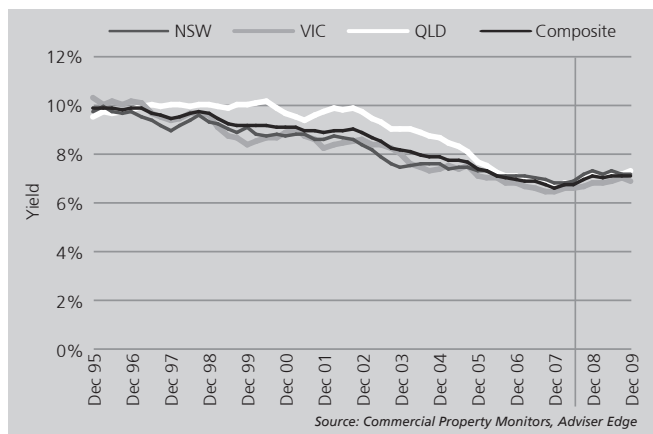
The national 10-year average annual increase in capital values is 9.2% p.a. Clearly 2007 has been an above average year for the office market.

Office Capital Values



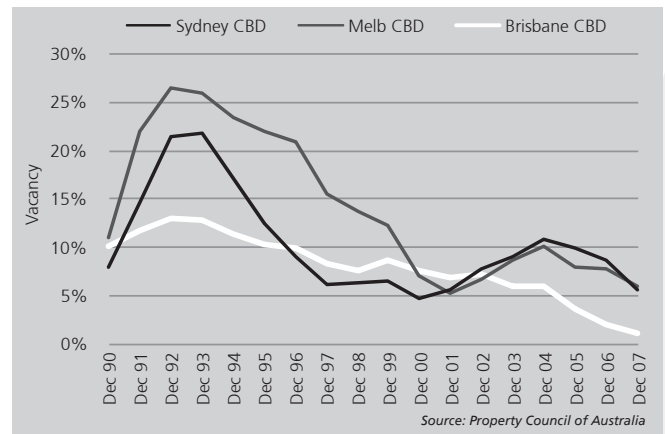
With the gain in capital values, yields have compressed over the year. Average national office yields stand at an estimated 6.8% for 2007, down from the 7.2% recorded for the same period in 2006. 2008 is expected to bring a reversal of the previous year's compression, with yields outshifting to 6.9% as investor's enthusiasm for office property begins to wane. This outward momentum of yields is expected to continue into 2009.

Office Yields



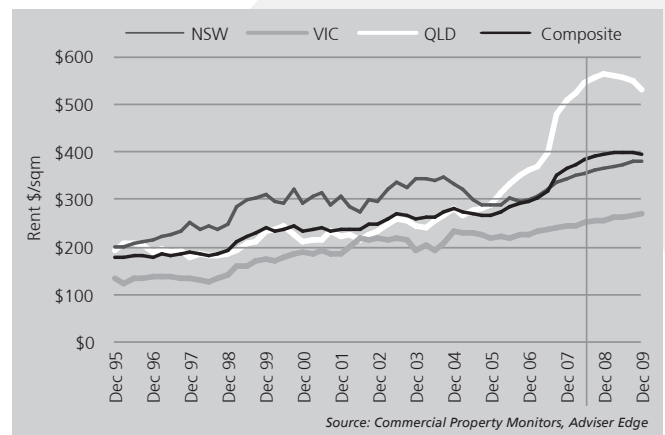
National CBD office vacancy rates fell in all three eastern seaboard states during 2007. NSW recorded the largest fall in vacancy rates, dropping from 8.6% to 5.6%, whereas Queensland went from an already tight 2.0% to a highly restrictive 1.2%. Overall, office vacancies ran at 5.4 % in 2007, a notable decline from the previous year's figure of 7.5%.

Office Vacancy Rates



As the chart illustrates, national office vacancy rates have been falling since the second half of calendar 2004, a reflection of higher rates of office absorption (a measure of demand) over that time combined with a stable office supply environment. The tightening in office vacancy rates has in turn put upward pressure on rents across the country.

Office Rents



Nationally, office rents rose by an estimated 23.9% during 2007. This figure was bolstered by the significant out performance of Queensland, with a rise of over 40%. NSW and Victoria recorded more moderate increases of 15.5% and 8.4% respectively. The dynamic rental growth of the previous year is predicted to slow in 2008, as economic uncertainty coupled with an increased inventory of office space takes the heat out of the market.

Supply on the Rise

Since 2004, supply levels of new and refurbished offices have slowly risen from their 1990s lows in response to a gradual increase in demand and a wind down from surplus stock created as far back as the late 1980s recession. The relatively subdued supply that was evidenced through 2007 can be attributed to the impact of weaker rental growth in 2004-05 and high construction costs on project feasibility.

Financial year 2008 will see a marked uplift in supply levels for the capital cities of the eastern seaboard, growing by an estimated total of approximately 377,000sqm (2007: 150,000sqm). This increased supply has been triggered by strong economic growth over previous years, lagged by the 2–3-year development period for a substantial office building. The spike in supply will more than likely lift vacancy rates from their current levels and therefore reduce the upwards pressure on rents over following periods, unless demand is far higher than anticipated.

Let us now consider the performance of each city.

National Office Market 2007 ¹ in Detail						
	Rental Growth	Capital Value Growth	Yield	Total Return	Total Vacancy	Supply Additions (sqm)
Sydney CBD	20.9%	17.9%	6.5%	24.4%	5.6%	74,522
North Sydney	19.7%	9.4%	7.0%	16.4%	8.3%	28,448
Parramatta	9.7%	13.9%	7.5%	21.4%	8.2%	48,966
Melb CBD	21.6%	8.8%	6.5%	15.3%	5.9%	50,822
St Kilda Rd	13.0%	9.4%	7.2%	16.6%	8.6%	0
South Bank	30.0%	28.6%	7.2%	35.8%	4.4%	1,353
Brisbane CBD	53.6%	45.9%	7.0%	52.9%	1.2%	23,935
Brisbane Outer	25.8%	24.2%	6.7%	30.9%	1.3%	56,879
Gold Coast	16.1%	27.3%	6.2%	33.5%	5.0%	18,350
Canberra	12.9%	2.9%	7.5%	10.4%	1.3%	210,136
Perth CBD	21.4%	40.0%	7.0%	47.0%	0.7%	13,477
Adelaide Core	63.2%	34.6%	7.0%	41.6%	8.2%	1,800
Hobart CBD	0.0%	5.6%	8.8%	14.4%	1.9%	0

Source: CPM Research Data (based on median quarterly \$/sqm rental and capital value figures), Property Council of Australia, Adviser Edge

¹ Includes partial forecast data

Sydney

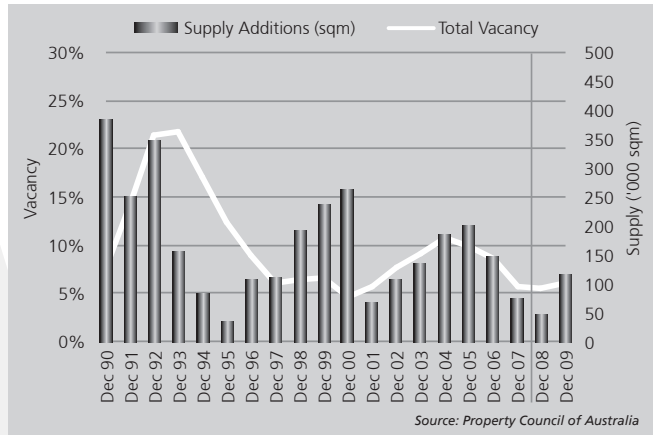
The Sydney office market has maintained its recovery after the downturn of 2003–05. Prime CBD vacancy rates have fallen to 5.6% after reaching a cyclical peak of 11.2% in the second half of 2004. Assuming demand remains at current levels, vacancy rates should fall further during 2008 to approximately 5.5%.

Overall, rents in the greater Sydney area rose by approximately 15.5% during 2007, with CBD rents experiencing an enhanced uplift of 20.9%. However, growth is expected to moderate in 2008, with a forecast rise of 6.4% for the year based on an expected tightening in economic conditions. The outlook is more positive for CBD office, where it is believed that the higher quality and greater demand should maintain double digit rental growth.

Office yields are believed to have stabilised at 7.0% in 2007, with 2008 predicted to bring a slight out shift to 7.1%. However, it should be noted that there is considerable variance in this figure, reflective of the range in both quality and location.

A rise in capital values of approximately 17.9% was recorded for 2007, driven largely by rental increases. When coupled with the yield compression, total direct office returns for Sydney ran at 22.2% for 2007 before tax. Increased economic uncertainty places pressure on this figure in 2008, with direct office returns predicted to fall to 16.7%.

Sydney CBD Office Supply, Vacancy Rates including Forecast



An additional 75,000sqm of new space was added to the inventory of Sydney CBD office space in 2007, considerably below the long term average of 180,000sqm. At this stage, supply of new/refurbished office space is forecast to fall to approximately 48,000sqm in 2008, further increasing supply side pressure.

Going forward, the key risks to the Sydney office market in 2008-09 include a downturn in the domestic and world economy, and an above expected lift in supply. However, there is also a risk on the upside that demand could rise above expectations, and if this were the case, vacancy rates could tighten further than anticipated.

Overall, we recommend a selective approach to direct Sydney office property in 2008. The continued demand and limited supply of high quality CBD office is likely to provide some protection against forecast economic uncertainty. However, lower quality and suburban office property is expected to be increasingly vulnerable to reduced demand and tenant defaults.

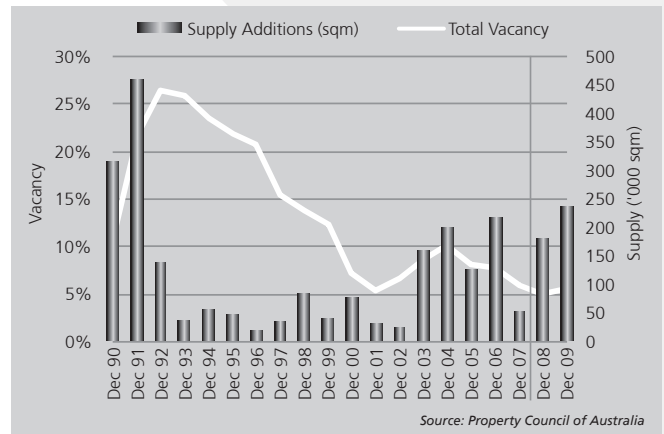
This dichotomy has already been evidenced, with the differential between the passing yields on premium CBD office and low grade suburban office currently approaching 5%. While high yields may provide opportunities, especially for developers, the fundamentals of location and quality should now be investors' primary concern.

Melbourne

Melbourne has continued the reduction in rental yields of the previous two years, albeit at a reduced pace. In 2007 CBD office yields measured 6.5%, a marginal contraction from the 6.8% figure recorded the previous year.

The prevailing decline in yields is believed to be a result of investors' expectations of ongoing rental growth combined with the search for capital placement by institutional investors. Melbourne market rents rose by an impressive 21.6% during 2007. This was assisted by supply constraints in 2007, as only of 50,000sqm of new stock became available during the period, considerably below the long term average of 124,000sqm.

Melbourne CBD Supply, Vacancy Rates including Forecast



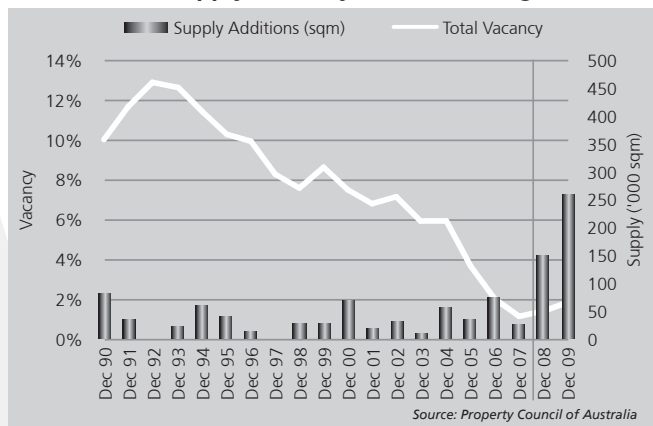
Going forward, new office supply will increase in 2008, with 181,000sqm of office space planned to be completed. Despite the increased supply, tenant demand is expected to be sufficient to reduce the CBD vacancy figure to 5% for 2008.

In the face of increased supply, rents are likely to undergo a slight rise of approximately 6% in 2008, supported by the overall improvement in the quality of available stock. Yields are expected to tighten slightly to around 6.5%. As was the case in Sydney, prime CBD office will outperform these figures due to a continued demand for higher quality premises. For premium grade Melbourne office, 2008 is predicted to bring rental increases above 10% with yields that will test the 5.5% mark.

Our expectations for total returns in Melbourne for 2008 are approximately 17%.

Brisbane

Brisbane CBD Supply, Vacancy Rates including Forecast



Due to strong demand for commercial office space and limited supply, 2007 has seen capital values rise by an unprecedented 45.9%, and rents lift by over 50%. Given the rise in rents, yields have tightened to an estimated 7.0% for 2007, with premium grade office transactions being conducted on yields of below 6.5%. Office vacancy rates in the Brisbane CBD hit 1.16% for 2007 – the tightest since records begun. The ongoing out performance of the Brisbane office market has been propelled by continued increases in finance sector employment and overall population growth for southeast Queensland.

2008 is a less certain prospect. It is believed that the momentum of 2007 will carry over into this year, but will be moderated by a combination of increased supply and general economic unease. Overall rental growth is expected to be approximately 11%, although this figure will be falling away by the end of the year. Once again, prime CBD office will outperform and should achieve rental growth of 20%–30%.

The predicted credit tightening will see 2008 yields soften by approximately 20bp as investors factor increased finance costs into pricing. An overall yield of 7% is expected, with prime office property trading on a premium of around 1%. A similar pattern is expected in 2009.

As illustrated, there is currently a pipeline of 149,000sqm of office space set for completion in 2008, and an estimated 259,000sqm for 2009. While vacancies are currently tight, questions must be asked about the huge volume coming online in 2008 and 2009. **Reports that the heady climate has encouraged developers to build without substantial pre-commitments to capture rental growth nearer to completion are concerning, especially as storm clouds are now gathering on the horizon.**

Overall, we hold a neutral bias for the Brisbane office market. While the market has outperformed in recent years, questions remain about the outlook over the next two years.

Overall National Office Outlook

Our forecasts are as follows:

- office yields will rise slightly through the first half of 2008 to approximately 6.9%, with further softening predicted in 2009, based on a slowing market and an increase in supply;
- rents to grow on average by 8.2% in 2008, with rents for premium grade CBD space to increase by 15%–20%. Rentals will be under pressure in 2009 due to a significant increase in office completions, particularly in Brisbane;
- capital values to rise on average by 9.8% in 2008; and
- overall forecast total returns to be 16.7% in 2008, falling to 13.8% in 2009.

Although the office market is forecast to slow in 2008, we maintain an overweight position on the sector for the coming year.

Retail Sector	Periods Ending December 2007 (Compounded)				Forecast Data		
Rental Growth	1 Year ¹	3-year	5-year	10-year	2008	2009	Dec 07 Qtr
NSW	-11.1%	2.9%	6.4%	3.3%	-1.9%	5.1%	-2.3%
VIC	0.0%	-6.1%	-1.8%	2.2%	1.6%	3.3%	0.4%
QLD	5.3%	12.0%	6.4%	5.2%	10.0%	5.0%	-1.5%
Composite	-4.2%	3.3%	4.5%	3.6%	2.7%	4.7%	-1.5%
Capital Value Growth	1 Year ¹	3-year	5-year	10-year	2008	2009	Dec 07 Qtr
NSW	2.0%	8.2%	4.8%	7.2%	5.2%	6.0%	0.6%
VIC	23.5%	13.7%	15.7%	13.3%	-1.2%	3.2%	2.9%
QLD	15.3%	15.8%	13.9%	8.5%	8.0%	9.0%	2.5%
Composite	12.9%	12.1%	10.7%	9.4%	3.5%	5.8%	2.0%
Yield ²	1 Year ¹	3-year	5-year	10-year	2008	2009	
NSW	6.3%	6.6%	6.8%	7.8%	6.4%	6.6%	
VIC	5.1%	5.4%	5.6%	6.7%	5.4%	5.5%	
QLD	7.2%	7.4%	8.0%	9.0%	7.0%	7.2%	
Composite	6.2%	6.5%	6.8%	7.8%	6.3%	6.5%	
Total Return	1 Year ¹	3-year	5-year	10-year	2008	2009	
NSW	8.3%	14.9%	11.6%	14.9%	11.6%	12.6%	
VIC	28.6%	19.2%	21.3%	20.0%	4.2%	8.7%	
QLD	22.5%	23.3%	21.9%	17.4%	15.0%	16.2%	
Composite	19.1%	18.6%	17.4%	17.3%	9.8%	12.3%	

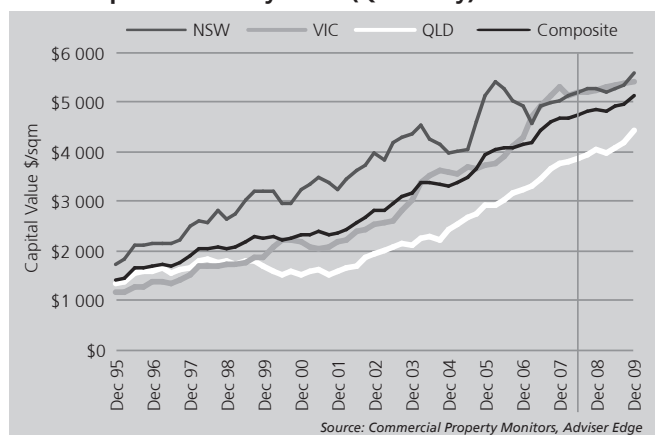
Source: CPM Research Data, based on quarterly \$/sqm rental and capital value figures

¹ Includes partial forecast data ² Average (non-compounding) data presented

Direct retail property has been regarded as the steady property performer over a number of years now, and looking at the numbers from CPM Research for retail last year, 2007 appears to be no exception, expecting a total return for the year of 19% (composite of NSW, Victoria and Queensland) which is 2% higher than the long term average!

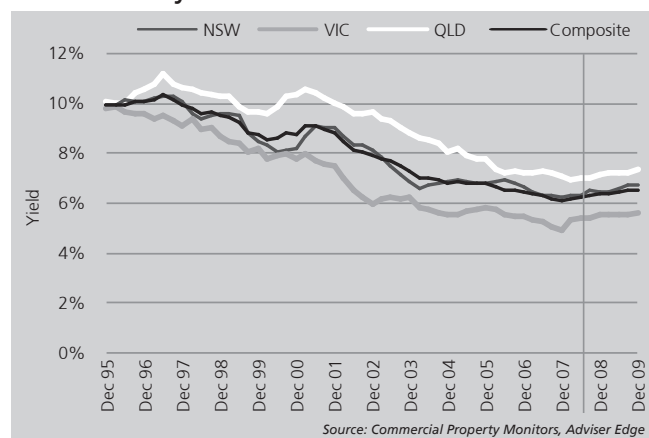
This strong result however is not expected to continue into 2008 as the slowdown in the US and the rest of the world takes effect.

Retail Capital Values by State (Quarterly)

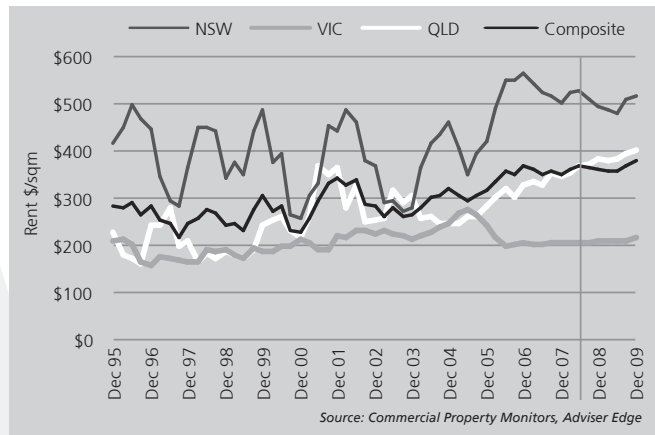


According to CPM research, retail property capital values Australia wide to December 2007 are running at an estimated 13%, largely driven by Victoria and Queensland, with returns of 24% and 15% respectively while New South Wales is expected to return 2%.

Retail Yields by State



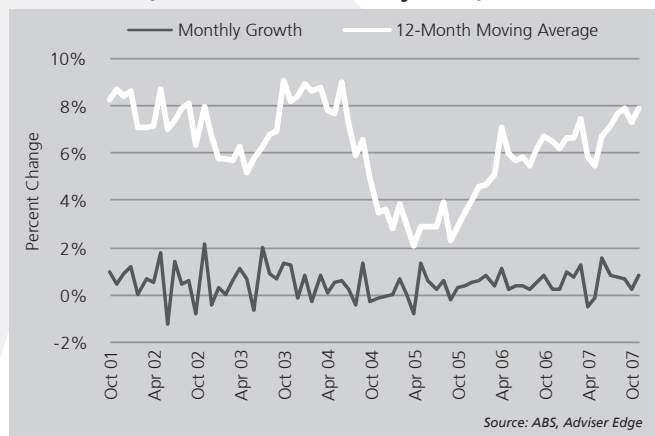
Retail Rents by State (Quarterly)



Movements in the retail rents have been more difficult to accurately measure. CPM data suggests a fall in market rents during 2007 for NSW, relatively flat rents for Victoria and increases in Queensland. The net result however, is an expected to be a drop in rents of around 4% on average for the three states.

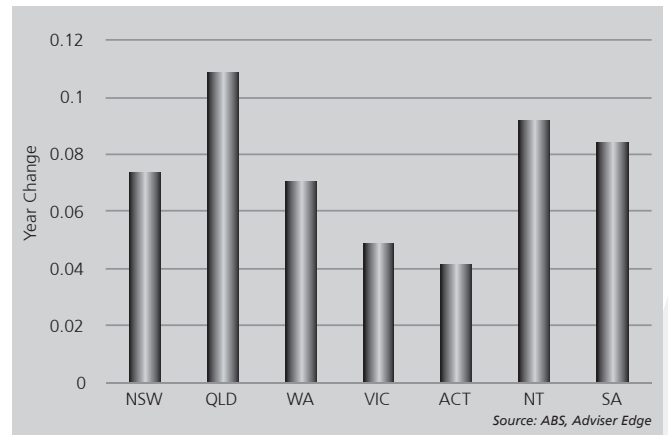
We are forecasting average rents for NSW, Victoria and Queensland to rise by only around 3% in 2008 and then to rise by 5% in 2009, however this is based on a small number of rental transactions only.

Retail Sales (with retail turnover by state)



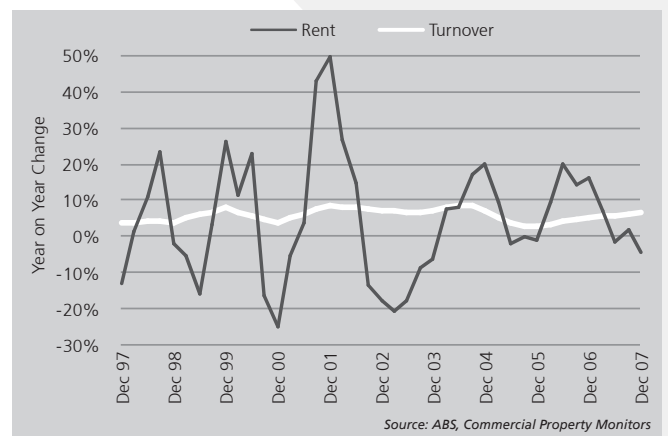
Retail sales have been accelerating through most of 2007 and are expected to jump in the December quarter. Retail sales were up by 8.1% for the year to November 2007. However in 2008 there may be a slowdown in growth rates of retail sales as further interest rate rises are expected.

2007 Retail Turnover by State (12-Month Change)



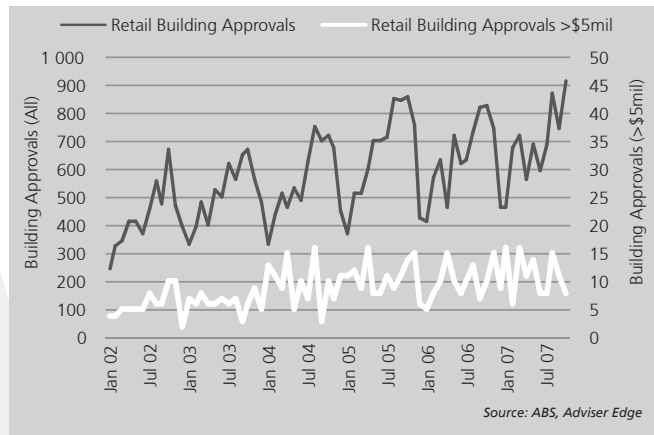
Growth in retail turnover by state has been highest in Queensland followed by the Northern Territory and then South Australia.

Rents versus Retail Sales



Our forecast for retail turnover in 2008 is for a moderate growth rate in retail sales of 5.0%. Rises in nominal wages and tax cuts, may dampen the effect of another 25 basis point rate rise. Given our forecasts for retail turnover, our forecast for rental growth is a modest 2.7% as an average of New South Wales, Victoria and Queensland.

Retail Building Approvals



As in 2006, growth in the number of smaller developments has accelerated in 2007 while growth in the number of larger retail properties has been relatively stable. This could be due to developers continuing the trend in refurbishment of sub-regional shopping centres which was observed in 2006 due to restrictions on larger scale developments.

Recommendation

We anticipate that retail will record relatively modest total returns in 2007 and 2008 of around 10% and 12% respectively, far lower than the 17% long term average. While there are signals that retail sales are increasing, we believe yields will remain stable, and rental growth will further decrease from 2007 levels.

Industrial	Periods Ending December 2007 (Compounded)				Forecast Data		
	1 Year ¹	3-year	5-year	10-year	2008	2009	Dec 07 Qtr
Rental Growth							
NSW	-5.0%	-1.8%	-2.2%	1.7%	1.9%	1.8%	0.4%
VIC	5.6%	6.3%	4.9%	5.3%	3.0%	1.7%	-0.3%
QLD	14.3%	7.9%	6.5%	5.0%	1.5%	-5.3%	2.7%
Composite	4.4%	3.7%	2.5%	3.8%	2.0%	-0.8%	1.0%
Capital Value Growth							
NSW	9.0%	2.9%	5.7%	6.8%	7.1%	4.0%	1.8%
VIC	19.6%	12.0%	13.2%	10.2%	7.6%	6.0%	7.4%
QLD	17.8%	19.0%	14.9%	8.7%	4.0%	0.0%	3.6%
Composite	15.0%	10.4%	10.7%	8.4%	6.1%	3.2%	4.0%
Yield²							
NSW	7.5%	7.8%	8.2%	9.0%	7.6%	7.7%	
VIC	7.4%	7.7%	8.0%	8.6%	7.5%	7.6%	
QLD	7.6%	7.9%	8.4%	9.1%	7.7%	7.8%	
Composite	7.5%	7.8%	8.2%	8.9%	7.6%	7.7%	
Total Return							
NSW	16.4%	10.7%	13.8%	15.8%	14.7%	11.7%	
VIC	27.0%	19.6%	21.1%	18.9%	15.1%	13.6%	
QLD	25.4%	26.9%	23.2%	17.7%	11.7%	7.8%	
Composite	22.5%	18.2%	18.8%	17.2%	13.7%	10.8%	

Source: CPM Research Data, based on quarterly \$/sqm rental and capital value figures

¹ Includes partial forecast data ² Average (non-compounding) data presented

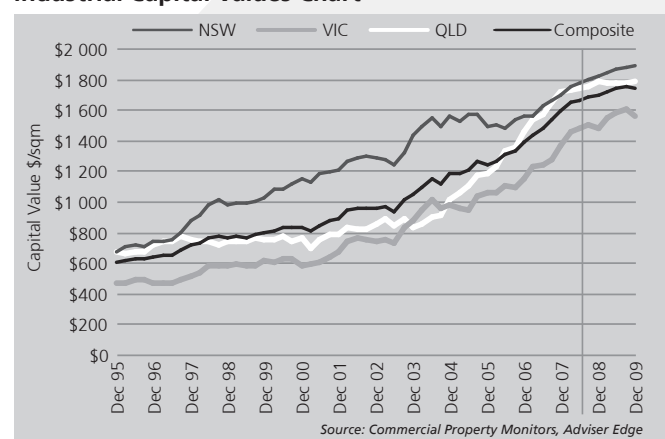
2007 has been a surprisingly positive year for industrial property investors, with total returns on industrial property substantially above long term averages.

Our forecast in April 2007 anticipated lower returns due to looming oversupply issues. Certainly there was an increase in supply, however, the impact on the market was not as severe as expected.

The impressive returns have been underpinned by the combination of falling industrial yields and (generally) rising rents. Continued investor demand has seen yields compress by about 1% during the year to 7.5%.

With the exception of NSW, most major states and cities have recorded solid rises in rents. Queensland has been the stand out performer, recording double digit rent increases.

Industrial Capital Values Chart

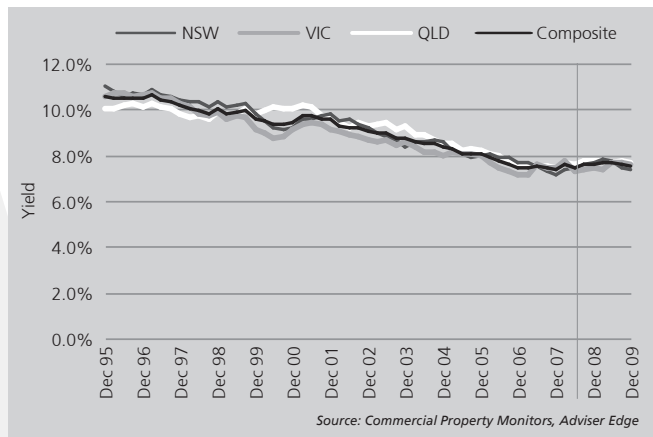


In 2007 all states have experienced increases in capital value above the long term average. Queensland achieved an increase of just under 20%, while NSW experienced a moderate 9% due to an ongoing correction from the heady growth of 2003-04.

Capital values will undergo moderate increases in 2008, with a range of between 4%–8% expected across the Eastern seaboard states. This represents a considerable reduction from

the double digit increases of 2007, as the cooling of the industrial market takes effect.

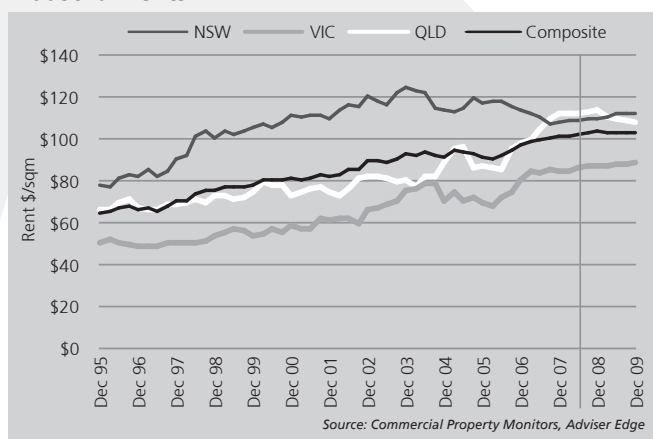
Industrial Yields



Direct industrial property yields have experienced sustained compression across all states in 2007, driven by continued demand from property trusts and other institutional investors (as experienced in other commercial). Average yields in the east coast cities are currently very similar, with Melbourne at 7.5% while Brisbane and Sydney run at 7.6% and 7.4% respectively.

Looking ahead, yields are expected to experience a softening in 2008 that will flow into 2009. While it is believed that industrial property will continue to attract investors due to relatively low entry costs and diversification benefits, increasing economic unease will impact on the yields achieved.

Industrial Rents



2007 has been a year in which Industrial rents in the three capital cities tested the supply demand equilibrium.

Median industrial rents in Melbourne had a positive year, with face rents rising on average by 5.6%. This has defied the predictions of many pundits, who felt an oversupply of stock would place downward pressure on rents. However, a number

of regions in Melbourne are faring worse than this result; the north and south of the city have been stagnant.

Sydney industrial rents have retreated by an average of 5% for the year on the back of increased supply in Sydney's west, exacerbated by a slowdown in NSW economic growth. However, it appears likely that Sydney industrial rents will reverse this trend going forward, and exhibit a tentative recovery. This increase will be largely due to improved quality of stock and an increased demand for larger scale distribution and warehousing facilities to take advantage of the improved logistics offered by developments accessing new roads.

Brisbane industrial rents have outperformed in 2007, rising by 14.3% to defy previous forecasts of a downturn. However, it is unlikely double digit increases will be sustained in coming years, as a forecast surge in development relieves supply side pressure.

Outlook

2008 will see the heat come out of the industrial property market in Brisbane, Melbourne and Sydney. This will be a general slowdown, with growth in most states capital values, rental increases and total returns down on 2007 figures. However, the continued momentum should be sufficient to see results remaining in positive territory, with total returns exhibiting a range of between 12%–15%.

The effects of the slowdown are predicted to take a firmer grip moving into 2009. Warehousing supply is expected to reach saturation point. Although there will still be some marginal growth in capital value and rentals, it will be driven by large funds utilising land holdings to build new developments at rental rates only slightly higher than older premises. Queensland will be stretched to maintain the explosive growth of previous periods, and we expect to see capital values stall and a contraction in rental levels. Across all states, yields will continue to soften as investors become more selective and price conscious. Overall, we believe that total returns for industrial property will fall to 10.8% in 2009

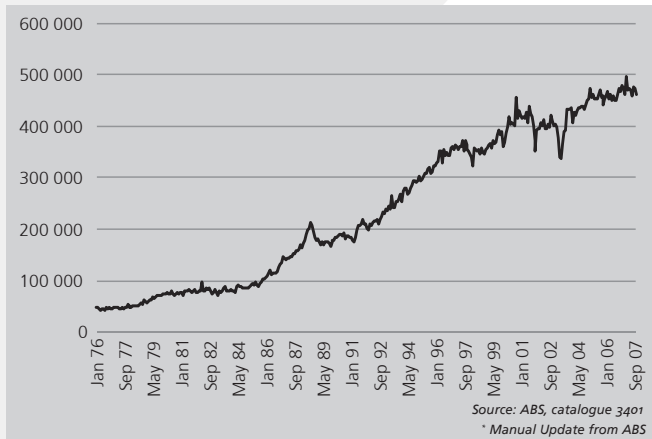
Adviser Edge's overall position is net neutral to underweight for national industrial property, with large scale warehousing and distribution facilities appearing a preferred option to manufacturing.

As hotel property transactions are so few and far between, statistics in this area of the property market are negligible. This of course makes independent measurement of the market very difficult for analysts.

Many of the views on this sector have been based on anecdotal evidence only, with the exception of the statistics from the respected research house Dransfield & Co plus the Australian Bureau of Statistics.

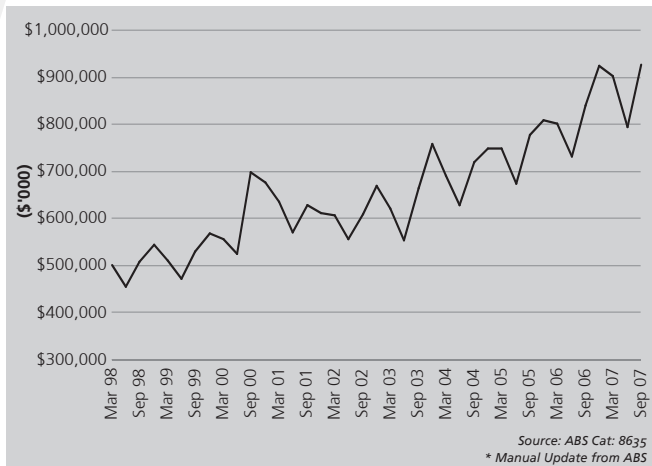
After several years of underperformance due to various factors outlined in our April 2007 report, the Australian hotel market has experienced a recovery with yields for the year to June 2007 recording a higher than expected 12%, predominantly due to an average rate of growth of 7%.

Overseas Visitors



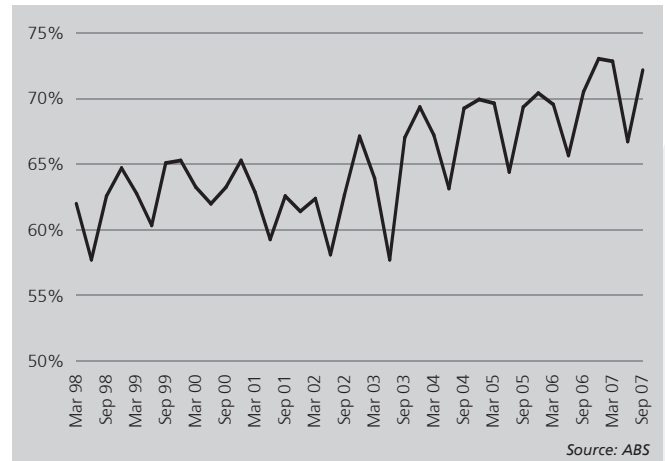
Although recent appreciation on the Australian dollar relative to the US, Japan and China has affected demand, this has been offset by increased price competition among new and existing aviation companies and visitors are expected to increase over the coming years.

Hotel Takings



Whereas hotel room rates have stagnated in the past, they are now increasing and expected to continue in the short term, especially in Sydney, Melbourne and Brisbane at least so far as supply remains low.

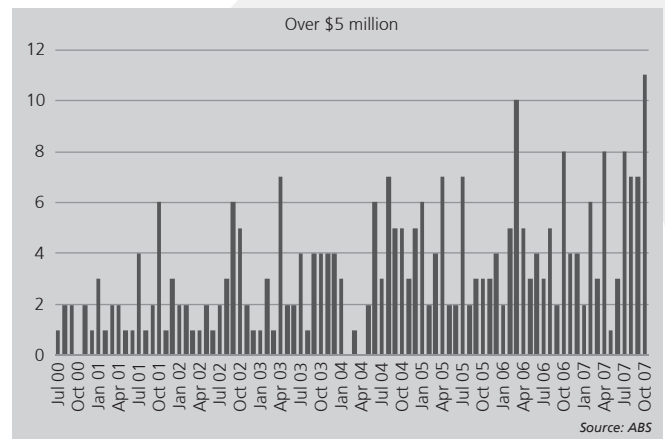
Hotel Occupancy Rates



As well as high room rates, very high occupancy rates have also pushed yields up during 2006 and 2007.

Accommodation Building Approvals

However, after a period of low supply as a response to reduced demand, supply of new hotels is now starting to increase in Brisbane, Perth and Melbourne. This may result in the current increases in rates to fall back in the period 2008-2010.



Hotel Rack-Rate and Occupancy Yields

Market	Supply		Demand		Average Room Rate		Room Yield	
	June 07 Qtr % Change	HF 06 F'cast For 2007 % Change	June 07 Qtr % Change	HF 06 F'cast For 2007 % Change	June 07 Qtr % Change	HF 06 F'cast For 2007 % Change	June 07 Qtr % Change	HF 06 F'cast For 2007 % Change
Adelaide	-3.4%	2.0%	-0.5%	3.5%	6.3%	3.5%	9.5%	5.0%
Brisbane	4.8%	5.5%	4.9%	5.5%	9.6%	6.0%	9.7%	6.0%
Cairns	5.2%	5.6%	-0.5%	4.5%	1.5%	4.0%	-0.4%	2.9%
Canberra	-1.5%	1.4%	-1.5%	3.0%	12.3%	3.0%	12.3%	4.6%
Darwin	-1.7%	4.2%	1.2%	5.0%	12.4%	3.5%	15.7%	4.3%
Gold Coast	-0.8%	4.4%	1.0%	4.0%	5.2%	6.0%	7.1%	5.6%
Hobart	-0.6%	1.5%	3.1%	3.0%	2.6%	5.5%	6.4%	7.1%
Melbourne	1.1%	2.0%	4.5%	4.0%	5.3%	0.0%	8.7%	2.0%
Perth	0.0%	3.0%	4.6%	6.0%	17.0%	7.0%	22.4%	10.1%
Sydney	1.7%	3.0%	7.2%	5.0%	5.1%	4.5%	10.8%	6.5%
Total Market	1.0%	3.3%	3.5%	4.5%	7.0%	4.0%	9.7%	5.1%

Source: ABS Catalogue 8635 and D.A Dransfield & Co 2007

* Updated Manually from Dransfield Report and ABS

Room yields recorded by Dransfield & Co were 9.7% for the June quarter of 2007 and as high as 12% for the year to June 2007. These are high compared to other asset classes have resulted in an increase in institutional interest over 2006-2007.

Despite the high yields in this sector, this asset class is heavily dependent on the tourism and leisure sector which makes it more volatile than other property classes.

However current trend continue to suggests that hotel rents will continue to rise at an annual rate beyond the CPI for at least the next year, or until such time as supply of 4-5-star hotel accommodation increases.

A slower economy may also negatively influence this sector.

Overall we recommend a cautious overweight position in this sector.

An emerging public awareness of the link between climate change and the built environment is increasing the Australian property market's focus on green buildings. However, this change is being driven not only by environmental considerations but also by a growing realisation of the link between environmental and financial sustainability. As the concept of sustainability is often an abstract one, and can be difficult to define, the Green Star rating system has become an important component in the building industries transition to sustainable development. The Green Star ratings provide a clear and comparable measure of the environmental design and achievements of buildings.

Green Star Rating

The Green Building Council of Australia (GBA) launched the Green Star environmental rating system for buildings in 2003. The key objective of the Green Star rating is to encourage sustainability by promoting green building programs, technologies, design practices and operations. These objectives are delivered by integration of green building initiatives into the design, construction and operation of buildings.

In order to evaluate the success in obtaining these objectives, projects are rated against eight environmental impact categories, plus innovation. Within each category, points are awarded for initiatives that demonstrate that a project has met the overall objectives of Green Star and the specific criteria of the relevant rating tool credits. Points are then weighted and an overall score is calculated, determining the project's Green Star rating.

Four-star recognises best practice; Five-star recognises Australian excellence; and the top rating Six-star recognises world leader. Ratings are sector specific, covering not only commercial buildings but also shopping centres and health-care education. The GBA is currently creating a rating tool specifically for the industrial sector, and multi unit residential. These ratings are available to both new and existing buildings.

At present there is no current legislative compulsion for developers or builders to adhere to or disclose the environmental performance of commercial buildings. The GBA supports this voluntary approach. Rather than mandating Green Star, they would prefer governments to offer incentives (e.g. grants, faster planning application process for projects seeking Green Star certification etc) to encourage and support sustainable development.

Impact on Commercial Building

Greater awareness of the benefits of building green has seen the number of projects registered for Green Star certification rise from 100 in December 2006 to 417 in October 2007. A further 33 projects have already achieved Green Star certification. This groundswell of interest has been particularly strong in Victoria, which has accounted for nearly half of all projects seeking certification. Of the total projects certified by the Green Building Council, an overwhelming majority have achieved a 5-Star rating.

The additional cost of incorporating environmental features in a new development can be surprisingly small. Market sources estimate that there is zero marginal cost to build to a four star standard, with a five-star building usually incurring between a three to 5% increase in the construction costs. However, costs escalate at the top end, and it is estimated that to raise a new buildings rating from five stars to the top level of six stars would increase build costs by approximately 7%.

Obtaining an accurate life-cycle costing for sustainable buildings is increasingly important as developers and owners seek to quantify the economic effect of going green. As a result, The Green Star for Property Professionals will be rolled out in 2008 to equip Property Managers, Leasing Agents, Facility Managers and Chartered Surveyors and Valuers with an understanding of Green Star and how to best apply this knowledge to their own Industry sector.

At the time of writing, market evidence shows that increased construction costs are not being reflected in a rental premium. Rather than providing an immediate financial advantage, the higher initial capital costs of sustainable buildings are recovered over the long term. Improved energy efficiency and reduced water usage have a direct effect on operating expenses, while the use of non-toxic building materials has been linked to lower levels of staff absenteeism. Furthermore, it is anticipated that the reduction in both operating costs and building obsolescence will result in a firmer cap rate being applied when valuing green buildings.

One immediate advantage of green buildings is a demonstrable improvement in time to lease. However, while environmental credentials are an important consideration with new developments, they are a lesser factor with existing stock, where traditional considerations such as location, profile and quality continue to hold sway.

Conclusion

No longer merely the domain of ideologists, sustainability has emerged as a genuine consideration for the traditionally hard headed property developers, builders and occupants. The exponential growth of the Green Star rating system demonstrates the market support for a clearly defined measure of buildings environmental credentials.

Adviser Edge believes that environmental considerations have become a factor requiring attention when assessing property investments. Therefore, sustainability in both design and operation will be taken into account in future ratings of direct property. In this respect, buildings that have achieved a green star rating will hold a clear advantage over those with no tangible measure of environmental impact.

The sub prime mortgage crisis in the US has caused panic in the global financial markets. The Federal Reserve in the US has to respond by continually dropping interest rates in order to try to reduce the fallout, even while there are signals that inflation is on the rise.

The problem is complex and by its nature difficult to quantify. This is reflected by numerous articles on the topic quoting different numbers, unclear definitions and differing opinions on the severity of the problem.

While its origins are in the US, there is now evidence to suggest it has spread into Europe and the rest of the world via the global securitisation markets.

This section discusses any potential parallels between the Mortgage markets of the US and Australia to determine whether there is the potential for a similar problem in this country.

We note the following:

- there is no clear definition of a sub prime mortgage in the US, let alone a direct equivalent in Australia;
- having said that, the closest thing to a sub prime mortgage in Australia is a 'non-conforming' loan;
- however, the segment of US Sub Prime mortgages causing most of the problem, Adjustable Rate Mortgages (ARMs), differ from our non-conforming loans as our honeymoon rates are far less generous, which can jump sharply after two to three years;
- Australia's non-conforming mortgage sector is not heavily regulated in the same way the banks are and therefore the data on default rates and trends is difficult to obtain;
- the way the products are bundled and securitised makes it difficult to track the extent of exposure in Australia;
- the large increase in growth of sub prime loans and the lag time between when the time a loan is written and when default rates jump (typically when the honeymoon rate finishes) means that there is not a lot of historical data to estimate future adverse trends; and
- similarly here for our non-conforming segment there has been a large growth in this segment recently and there exists only sparse historical data on trends in default rates in different economic climates, although we do know that they are significantly higher than prime loans and that their default rates are increasing.

Sub Prime Mortgage

While there is not even a clear definition of it in the US, the term sub prime mortgage generally relates to the credit worthiness (or rather, lack thereof) of the borrower. Such loans would be typically given to the types of borrowers that may not qualify for a standard loan due to poor credit history, often pushed by 'predatory' lenders who quickly pass on the risk to a third party after receiving a quick commission.

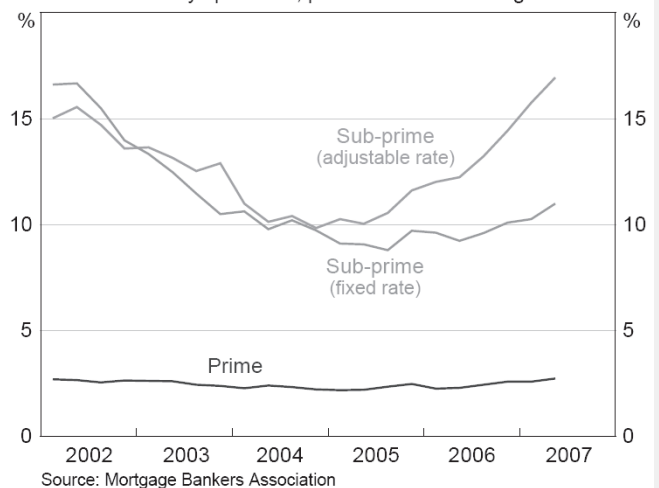
The Two Types

In the US there are two main types of sub prime loans, those with a fixed rate and those with a very low introductory rate which jumps after a about two years.

It is apparent when looking at default rates that these ARMs mortgages relative to standard mortgages and other sub prime mortgages that they are the main problem area.

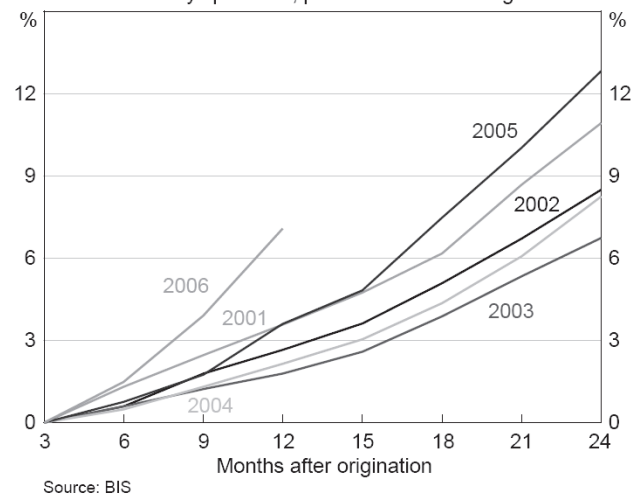
US Mortgage Delinquency Rates

30+ days past due, per cent of outstandings



US Sub-prime Mortgage Delinquency Rates

60+ days past due, per cent of outstandings



The exposure in the US for sub prime mortgages is quite high, around 15% of outstanding business and 20% new business written in 2006. The RBA states that ARMS make up the majority (being around 50%–67%) of these. Given that the majority of ARMS loans have a 2-year low introductory rate, the extent of the problems with those ARMS written in 2006 won't be apparent till 2008 and maybe 2009 due to the lag time.

Non-Conforming Loans

In 'comparison', in Australia the most risky loan segment (non-conforming loans) is relatively small, making up only about 1% of the outstanding mortgage market. However it must be noted that growth in this segment has been rapid over recent years.

'Alt-A Mortgages'

Another product has had rapid growth in the US and that is the 'Alt A' mortgage which accounts for about an additional 15% of the market. The closest equivalents we have to these loans are Lo-Doc and No-Doc loans. These borrowers are not necessarily credit impaired as are those with sub prime loans but the loans feature low documentation or high LVRs and would be given to borrowers who may not be able to verify income such as the self-employed.

Note that in the US the 'Alt A' loans account for about 15% of the market outstanding in addition to the 15% of sub prime loans, the two groups being mutually exclusive. However, in Australia the Lo-Doc and No-Doc market also contains a proportion of Non-Conforming loans, hence the difficulty on making a direct comparison.

Lo-Doc Loans

There has been a huge growth in the Lo-Doc market in Australia over the last few years, representing a tenth of new business written in the last few years and 7% of the all outstanding loans in 2007.

While not necessarily as risky as the sub prime or non-conforming loans, they are still more risky than the prime segment.

If we look at the growth of Low-doc and Non-conforming over the five years to 2006, the segments have *tripled* their new business market share from 4% of approvals in 2002 to 12% in 2006.

The following table is from the RBA Financial Stability Report 20/09/2007.

	Per cent of approvals				Per cent of
	2000	2002	2004	2006	outstandings
Prime loans					2007
Full-doc	>99	96	88½	88	92
Low-doc	<½	3	10	10	7
Non-conforming loans	<½	1	1½	2	1

Sources: ABS; banks' annual reports; RBA; Standard & Poor's

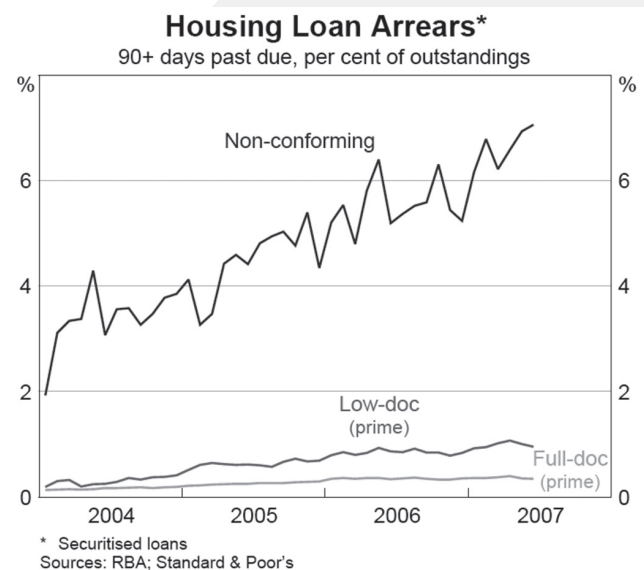
The other increasing trend is not just the number of higher risk loans but their average size and LVRs have also been growing and the interest difference between them and conventional loans has reduced.

So what are the problem areas in Australia?

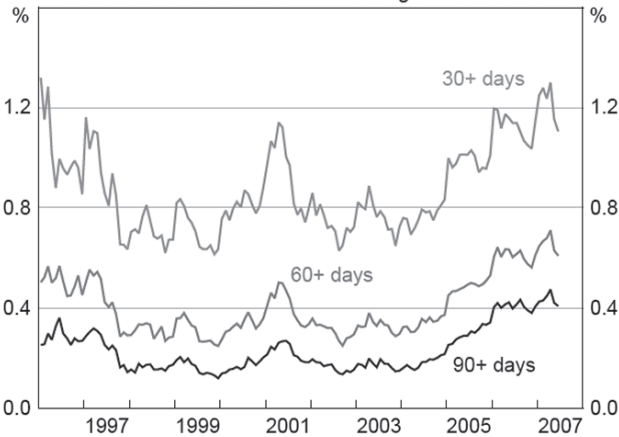
Given this is still not a direct comparison due to our different products, in particular the fact that we have not got the higher risk non-conforming 'ARMS' products, it might be a good idea not just to try and count the number of 'Sub Prime loans' we have but rather the trends in growth of our risky segments and the trend in default rates of them, compared to our conventional loan portfolios.

In a paper by the RBA in 2005, they state that a significantly higher proportion, that is 4% of non-conforming loans were over 90 days in arrears at the end of 2004 compared to 0.2% of other loans.

While default rates on Low-doc loans are far lower than Non-conforming loans, they are somewhat higher than prime loans.



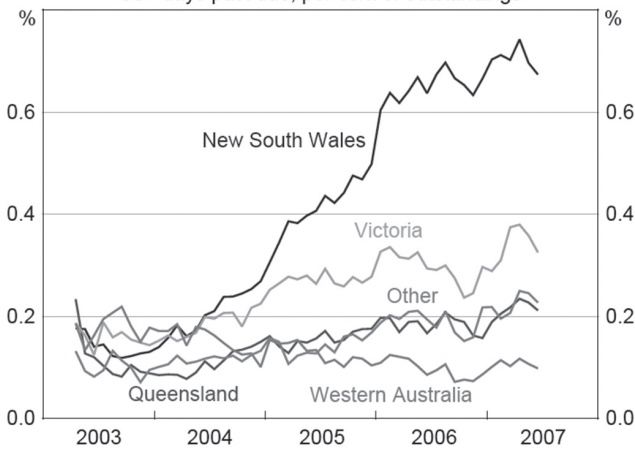
Housing Loan Arrears*
Per cent of outstandings



* Prime loans securitised by all lenders
Source: Standard & Poor's

If we now have a look at some data on loan arrears by state, we can see that housing loan arrears are highest and have increased markedly in New South Wales over the past three years.

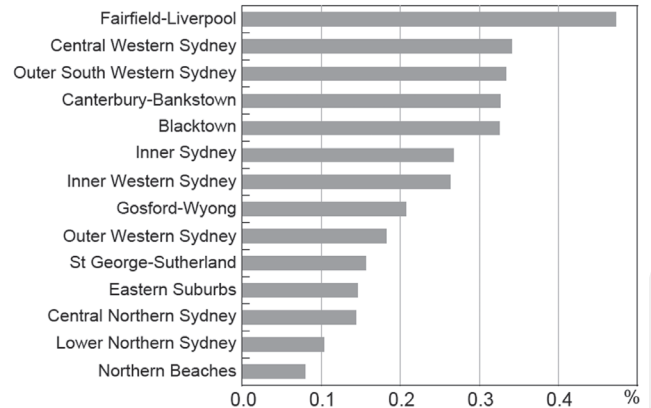
Housing Loan Arrears by State*
90+ days past due, per cent of outstandings



* Prime securitised loans
Source: RBA

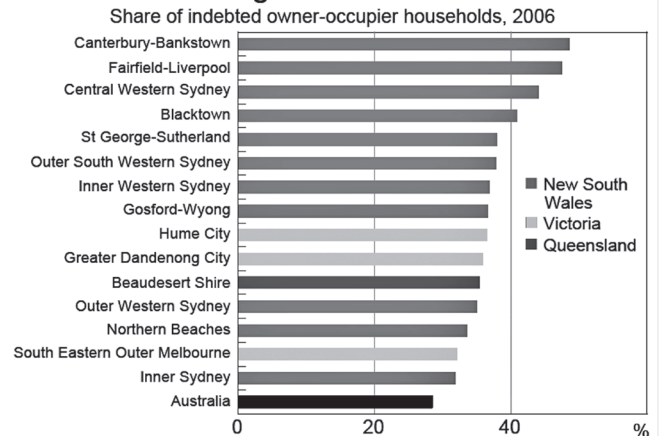
When we look at some the top locations for writs of repossession and high debt-servicing ratios, we see that Western Sydney in particular is over-represented, and this is one of the main factors stalling a price recovery in these areas, hence bringing down Sydney's median price overall.

Writs of Possession by Region
Per cent of dwellings, Sydney, 2006



Sources: ABS; Office of the Sheriff of NSW

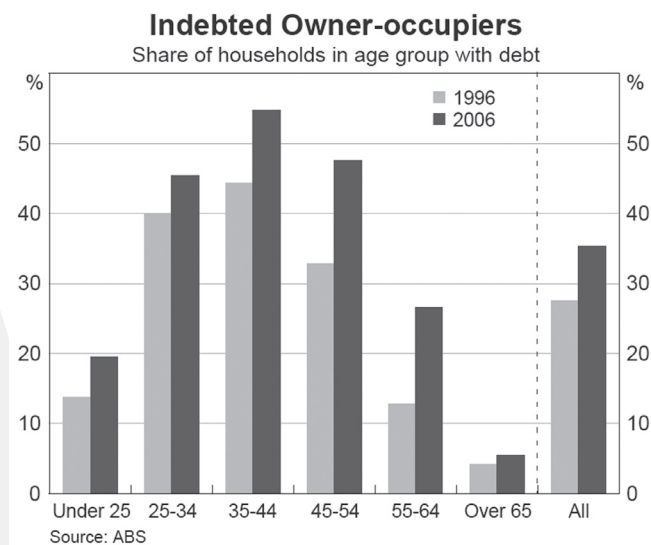
Households with Owner-occupier Debt-servicing Ratios Over 30 Per Cent
Share of indebted owner-occupier households, 2006



Sources: ABS; RBA

Hence we seem to have two markets in Sydney at present, one that is quite robust, in recovery and predicted to continue to grow and another that is struggling and will continue to struggle under the pressure of rising interest rates, high debt-servicing ratios or 'mortgage stress' and tighter lending practices as a result of the US crisis.

Interestingly, the biggest increase by age-group of households with debt over the last 10 years actually comes from that group that is most able to afford it; asset-rich baby-boomers refinancing to tap into their equity.



In Summary

The extent of the sub prime crisis in Australia seems to be limited so far to particular pockets and demographic locations which are particularly sensitive to interest rate rises. Given that there may be further rate rises on the cards, this problem may deteriorate further, however it does not look as though it will become widespread given other segments in Sydney and indeed other states are in a housing recovery.

What the crisis also highlights is the need to be able to quantify and regulate the number of high risk loan products out there including their default rates over time, as is done for the banking sector.

The fact that lenders have started increasing their rates independently of any rises by the RBA and taking higher risk products off the market suggests that the severe mortgage stress now being experienced in some areas will hopefully not prevail into the long term and this crisis was a scare that Australia had to have to prevent a bigger crisis as is being experienced in the US.

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The Growth of Listed Property

The global listed property market has seen phenomenal growth in the last decade, gaining not only acceptance but also high popularity among investors seeking to have an exposure to the property asset class. The attractiveness of listed property has been underpinned by its clear liquidity advantage over both directly held property, and unit holdings of unlisted property trusts, being easily tradable on an open market with low transaction costs. The market created by listed related securities and listed property trusts has also provided domestic investors unprecedented access to properties assets held overseas, promoting diversification at all levels.

Herein lies one of the largest advantages of the listed market over its direct counterpart. While holding a portfolio of property assets spanning the three principle sectors, and three principle east coast states of Australia is certainly possible given a high level of resources and funding, similar diversification held across the globe and covering all elements of the property market (development, management, and investment) requires far less monetary capital and may be rebalanced with cheap, timely, stock transactions.

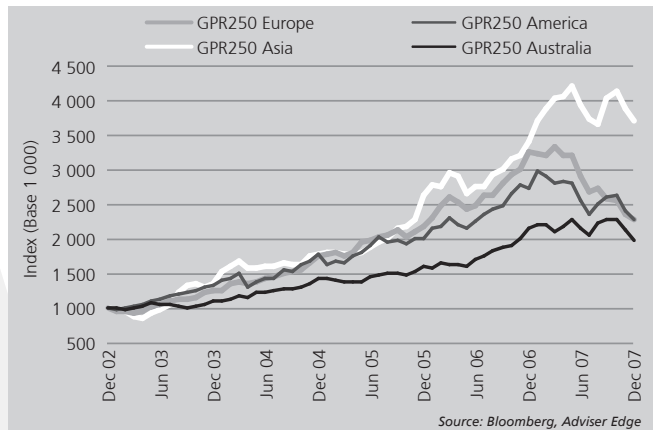
Companies undertaking property related activities (such as development and management) are similar to regular equities, paying returns largely from operating profits of ongoing business. The emergence and growing popularity of the listed property trust, operating in the same manner as the more familiar unitised property trust, has allowed investors access to fractional holdings of direct property assets in a liquid investment environment. These listed trusts pool shareholder equity to purchase and hold real property assets, distributing rental income in the form of periodic dividends.

Stapled Securities and REIT Legislation

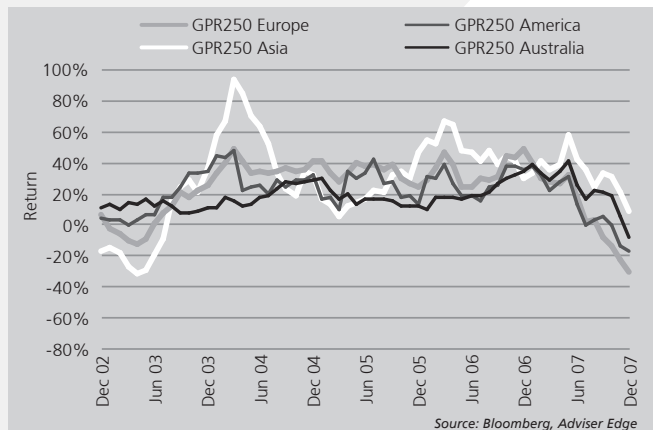
Often listings are made combining a portion of a property related business with units of a property trust. These “stapled” property securities pay dividends from both operating profit and rental income. While stapled securities allow for some exposure to directly held assets, “pure” listed property trusts have an investment profile much more closely aligned to that of the direct property market. As such, comparisons to the direct commercial market contained later in this report will be made against only those stocks identified as unstapled trusts.

While property trust legislation in Australia is quite mature, it is a relatively new structure in many regions, most notably within Europe. Referred to as LPTs (Listed Property Trusts) domestically, and REITs (Real Estate Investment Trusts) internationally, these structures allow a tax advantaged position compared to an incorporated entity with the caveat that income earned by the trust must be distributed to investors, and not retained. For listed trusts this typically means a payout ratio close to 1, however, this can be distorted by the non-distributable unrealised profits of property revaluations.

Global Listed Property 5-Year Index Performance



Global Listed Property Rolling 1-Year Return



The overall strong 5-year return of the global listed property market has been attributable to the development and refinement of REIT legislation, as well as increasing investor attraction to listed property vehicles and a generally sturdy underlying asset market. On a cumulative returns basis Australia, America, and Europe each returned above 100% in the period spanning December 2002 through December 2007, according to the Global Property Research 250 indices. The Asian index has been the standout, offering a return of 270% over the same period, largely driven by the strength of their emerging economy.

When viewing performance on a one year rolling basis the periodic surges of the Asian market are distinctly apparent, with Europe, America, and Australia's returns falling in a much tighter grouping. 12-month figures of 40% have not been an uncommon occurrence for any of the global markets, with Asia having notable peaks of 90%, 65%, and 60%. Over this five year horizon Australia has posted the least volatile returns, appearing as the "slow and steady" performer of the major regions.

The 2007 Market Collapse

While historical performance has been strong and largely consistent throughout the global property market, 2007 has

been nothing less than a tumultuous year for property securities. Despite there being little sign of trouble in the first quarter, the sub prime mortgage fallout within the US plunged the global market into chaos. As residential defaults skyrocketed, the once liberal lending environment tightened with unforeseen abruptness. This resulted in a similarly unforeseen and abrupt reactionary response by investors, well before the full extent of the damage could be assessed.

America and Europe were initially the hardest hit, with one year returns falling from their May 2007 peak of 31% to 0% by July 31 within both regions. The listed property stocks within Australia and Asia were also shaken considerably, and adding to domestic troubles was the \$500million collapse of the Australian property financier Bridgecorp. The regions, however, managed to retain notable one year performance to July 31 of 16.8% and 35.3% respectively.

Despite such large corrections, confidence in the market soon returned as analysts and commentators began giving the "all-clear" on US credit crunch fears, saying in retrospect that the problems were not as structurally engendered or widespread as initially reported. This gave rise to a strong resurgence within the listed property markets of America, Australia, and Asia.

Largely regarded as overpriced before the June/July "crises", and suffering from relatively weak fundamentals, European property stocks showed signs of instability as early as February with profit taking of 2006 gains taking its toll on prices. The downward performance trend of Europe continued through to the second revival of US sub prime worries in November.

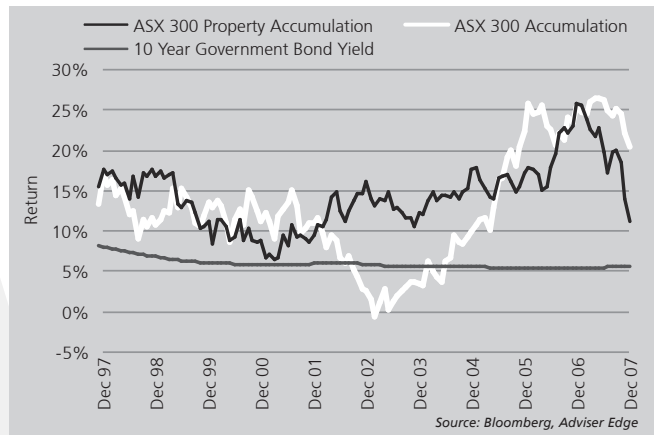
The Downfall of Centro

The reappearance of housing finance issues in the media brought the rebounds of the other regions to an end, with performance of the Australian listed property market being further undermined by the collapse of local property giant Centro during December.

The announcement that negotiations to roll over more than \$2bn in short term debt had broken down, leaving Centro at risk of insolvency, saw the closing stock price of \$5.70 before the trading halt on December 12 fall to just \$0.805 on December 18, just two days after re-opening. Centro's June market capitalisation of \$7.2bn plummeted to just \$0.85bn by December 30 as the stock price continued to fall, weighing heavily on the Australian listed market as a whole.

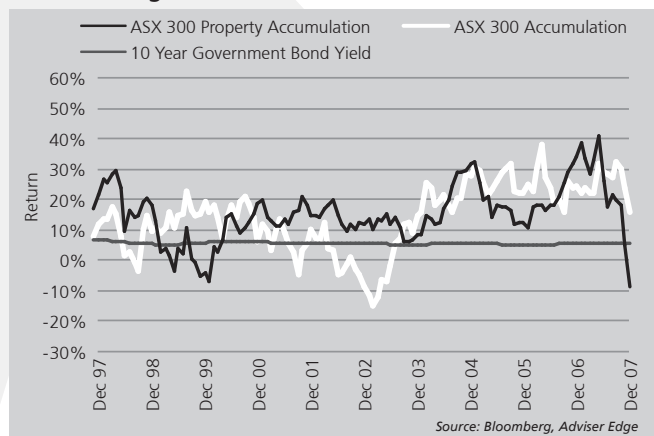
According to the Global Property Research indices Australia closed having a year ended return of negative 8.3%, with Europe performing the worst at negative 30%, America returning negative 16.2%, and only Asia managing a positive year end return of 8.8%.

3-Year Rolling Returns



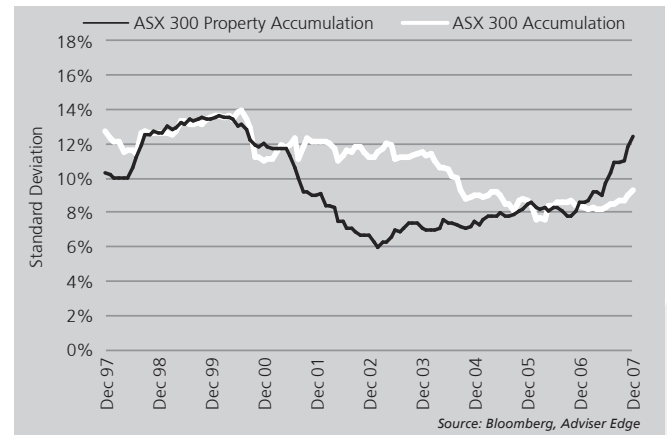
Shifting focus to the domestic listed market it can be observed that, historically, those stocks tracked by the ASX 300 Property Index have provided significantly higher consistency of returns than that of the broader listed market over both a one and three year rolling basis. In absolute terms however the differential between returns of the two indices has varied greatly over time. While property has experienced brief periods of notable outperformance compared to broader equities, it has also suffered from periods of moderate underperformance.

1 Year Rolling Returns



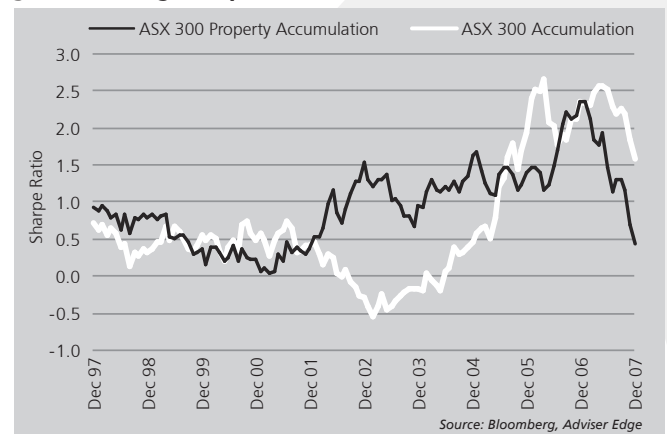
Throughout most of 2006 and the first half of 2007, property stocks posted record returns, as high as 40.8% with those of broader equities lagging behind. Following the US credit fallout though, the situation abruptly reversed. The second resurgence of credit fears exacerbated the ensuing return differential, with returns of the ASX 300 Property Accumulation Index dropping well below the 10-year government bond yield, or "risk-free" rate of return. For the year ending December 31, the property index closed at negative 8.4% while the broader equity ASX 300 Accumulation index held strong at positive 16.2%.

3-Year Rolling Volatility



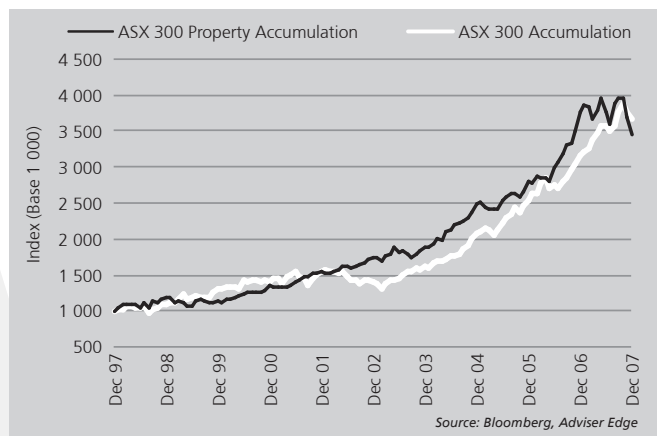
Congruent with the observations of three year rolling historical returns, there is a clear divergence between volatility of the property and broader equity indices. In the measured period, property stocks appear to have a risk profile either on par or below that of general equities. Recent history however has shown quite the opposite to be true, with the broader equity index performing at its lowest recorded levels of monthly volatility, while the standard deviation of the ASX 300 Property Accumulation Index returns has spiralled upwards on the back of US led instability and uncertainty.

3-Year Rolling Sharpe Ratios



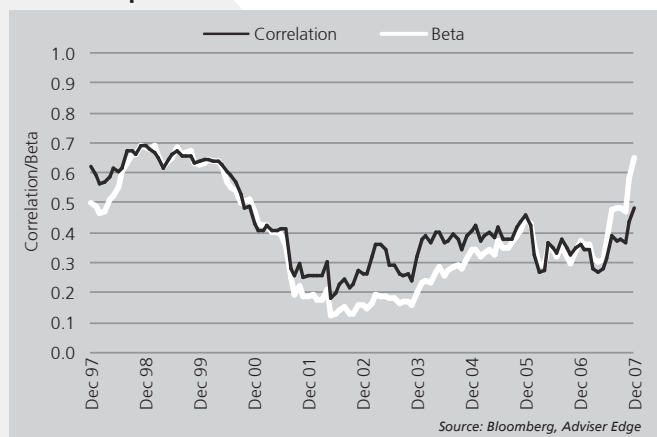
Returns on a risk adjusted basis are perhaps best understood through the Sharpe Ratio, measuring excess returns (those above the "risk-free" rate) per unit of volatility. The Sharpe Ratios of the ASX 300 Property Accumulation and ASX 300 Accumulation indices show property having provided impressive risk adjusted returns, on a three-year rolling basis, throughout the 2001–2004 period compared to those of broader equities. Given the recent falling return and spike of volatility, the current Sharpe Ratio of listed property has dropped to 0.44, representing a poor risk-return profile compared to the broader equities 1.59.

10-Year Cumulative Performance



Viewed on a 10-year cumulative returns basis property related equities are seen to have out performed the broader index substantially through much of the period. The cumulative return differential built up between the two however was greatly eroded in late 2007, with the rebased property index falling below that of broader equities for the first time since 2001.

3-Year Rolling Correlation and Beta of Property to Broader Equities



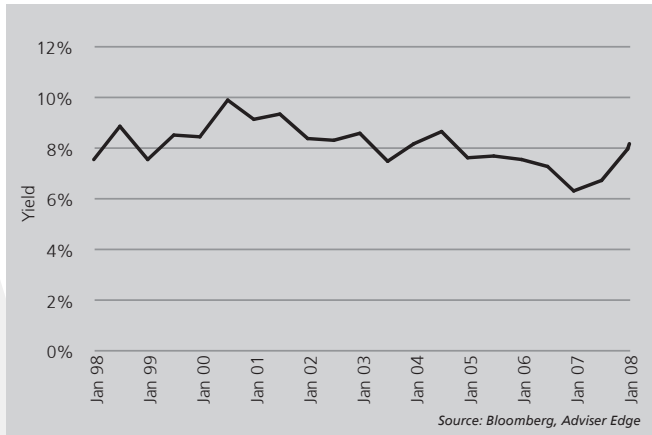
The correlation between the two indices has slowly strengthened over time from a historic low during 2002, and can be seen, along with the Beta co-efficient of the property index, to have risen sharply during mid 2007. The dramatic spike in Beta has been underpinned by both an increasing correlation as well as substantial increases in the volatility of the property index.

The Domestic Listed Market in Summary

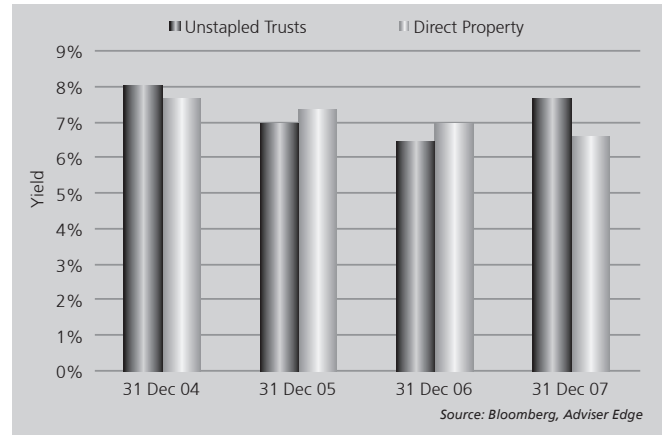
Currently, the domestic listed property market – as measured by the ASX 300 Property Accumulation Index – displays higher volatility and lower returns than the broader equity ASX 300 Accumulation Index, representing a sub-par investor return on both an absolute and risk adjusted basis. While historically the opposite has been true, the current irrational, reactionary, movements of many listed property stocks has painted a poor picture for the Australian property market despite returns of directly held assets remaining strong.

The divergence between underlying property fundamentals, and the performance of property related listed entities, is a direct reflection of shareholder uncertainty across all investor levels. Both personal and institutional shareholders alike have been spooked by dramatic changes in the lending environment, and are still unsure of the possible repercussions for the listed property market as a whole, especially those companies with high levels of gearing.

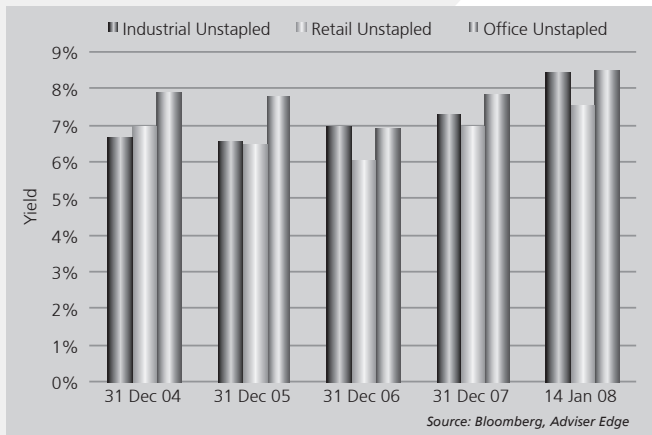
Property Stock Median Yields



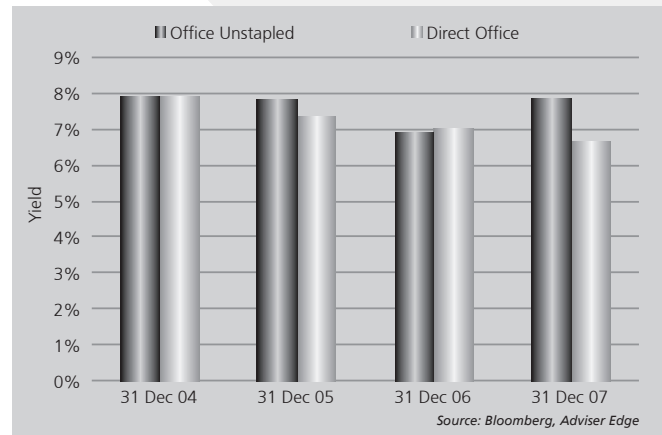
Direct Property vs LPT Yield Comparison



LPT Sector Yield Comparison



Direct Property vs LPT Office Yield Comparison



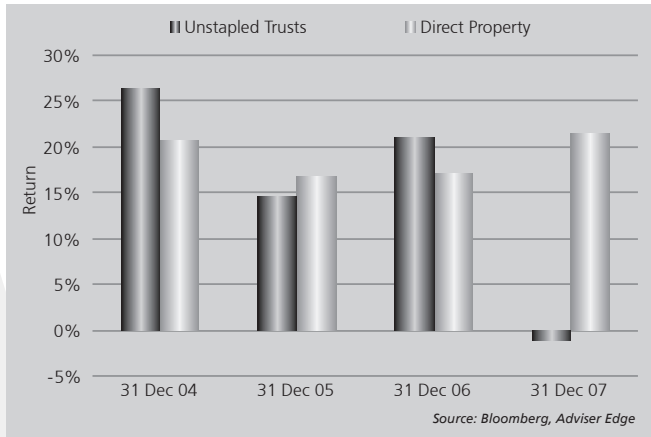
Despite strong rental income growth, surging prices throughout 2006 drove domestic yields on stapled and unstapled listed property trusts to a historic low of 6.8%.

The dramatic correction of the market during 2007, following the US led credit crises, resulted in a sharp up-swing of current yields – rising to 8% in December, and continuing this trend into the opening weeks of 2008. Historically it has been unstapled office trusts offering the highest yields within the listed property market, while retail has lagged behind.

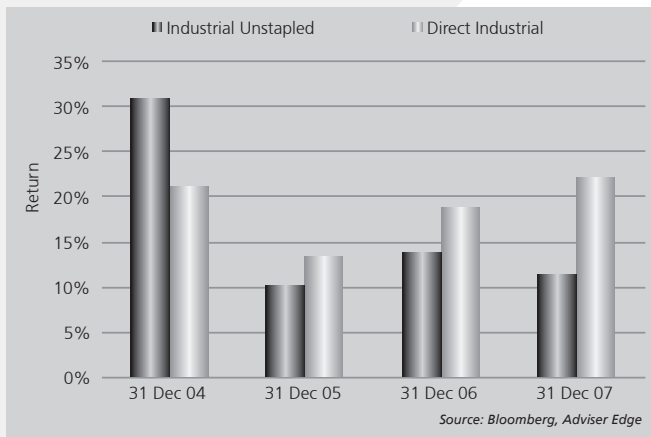
Given the liquidity and diversification advantages offered by listed property it is interesting to see a situation in 2007 where yields of unstapled listed trusts are above those of the direct market.

This is none more evident than in the office sector, where the yield differential between unstapled listed trusts and direct property has risen to over 1%.

Direct Property vs LPT Return Comparison



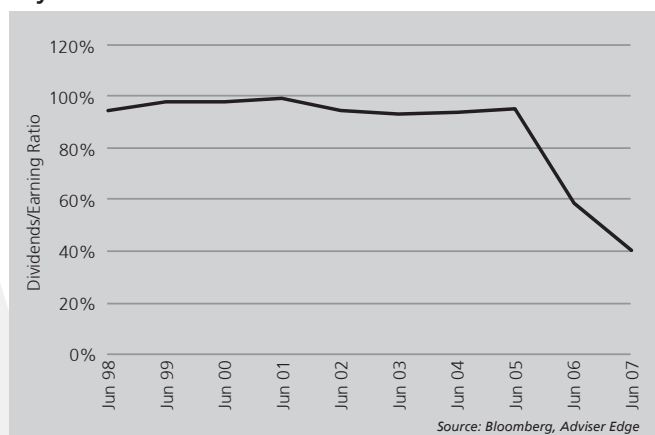
Direct Property vs LPT Industrial Return Comparison



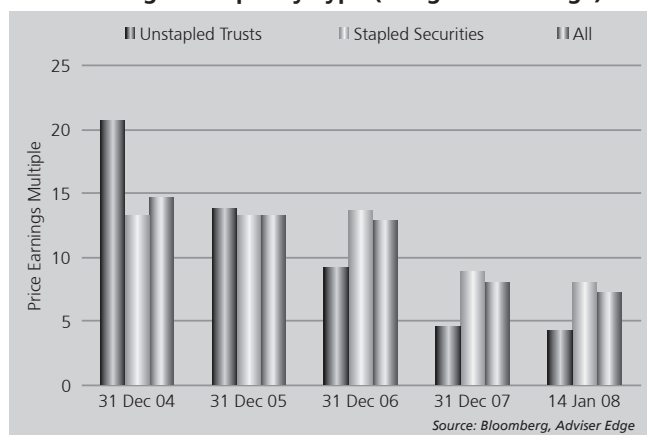
Despite rising yields lending a distinct attractiveness to the listed property market, when assessed on a total return basis it is clear that the consistency of direct investment, and its recent out performance, heavily outweighs the current yield advantage offered by unstapled listed trusts. While direct property returned 21.4% in the year ending December 2007 (based on an average of the three main sectors) unstapled listed trust performance plunged into the negative.

The overall return for office stock remained positive, at 0.4%, but it was industrial which appeared to be the most resilient of the three sectors, retaining a year ended total return above 10%. Despite this relatively strong return, unstapled industrial stock has continued to under perform when compared to directly held industrial assets.

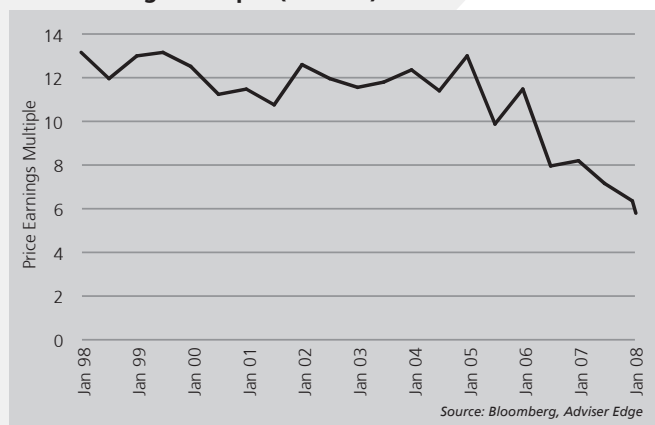
Payout Ratio Median



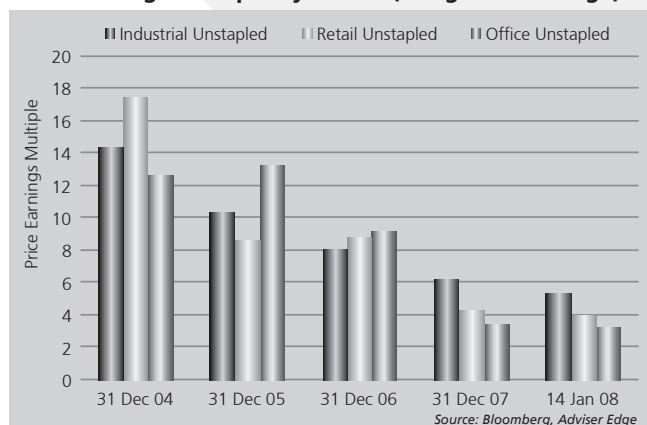
Price Earnings Multiple by Type (Weighted Average)



Price Earnings Multiple (median)



Price Earnings Multiple by Sector (Weighted Average)



Given the basic structure of listed property trusts, both domestic LPTs and global REITs, payout ratios are typically close to 100% with distributed earnings being predominantly derived from rental income. Although this appears to have not been the case through the 2006 and 2007 financial years, the steep drop off of the median payout ratio for domestic listed property has been caused largely by accounting distortion and does not reflect a true change of income distribution.

Strong accounting revaluations of property during 2006 and 2007 following soaring capital value growth has given rise to inflated earnings per share figures, generally derived as a combination of realised revenue from rents and profit on asset sales, as well these unrealised revaluation gains, in accordance with Australian Accounting Standards. While there is no standard for a distributable earnings per share calculation, most trusts adjust basic earnings per share for unrealised profits and set their distributions according to this figure.

Historically trading with a median price earnings multiple of 12, the as discussed inflation of earnings coupled with the recent freefall of prices has placed dramatic downwards pressure on this ratio.

The rapid decline in price earnings multiples is most strongly evident with unstapled trusts, falling from a weighted average of 21 in December 2004 to below 5 in December 2007.

As a subset of these unstapled trusts, office stocks are seen to be trading on the lowest price earnings multiples – while having the highest yield of the three major sectors. This is attributable to the underlying fundamentals of the direct office market, having seen not only high capital value growth, but also strong rental uplifts during 2007.

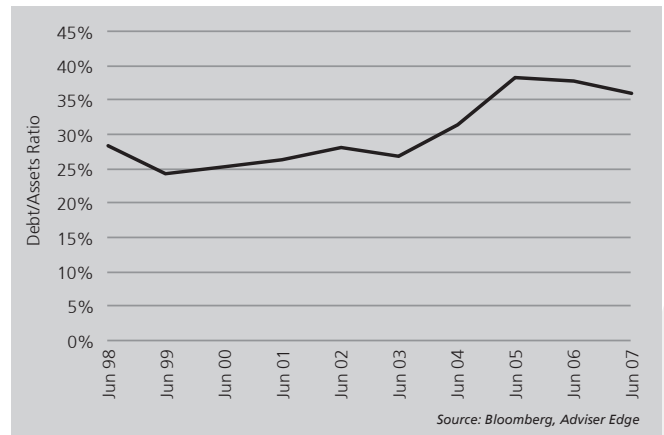
While historically median gearing has appeared stable, a trend towards higher proportions of debt to assets began to emerge in the 2004 financial year. Similar to the distortion of payout ratios and price earnings multiples, upward revaluations of assets has obscured growing levels of debt. The ever increasing ratio of debt when measured to equity however shows a clear shift of underlying capital structuring.

Although using leverage to purchase real property assets has worked advantageously in the past, allowing companies and trusts to gain access to higher value assets as well as providing stronger returns to investors, the June/July credit crises and ensuing uncertainty has put shareholders on alert. The returns of companies with higher levels of gearing, above the median, have suffered heavily in recent months – as have the returns of direct lenders and those otherwise exposed to mortgages, or mortgage backed securities.

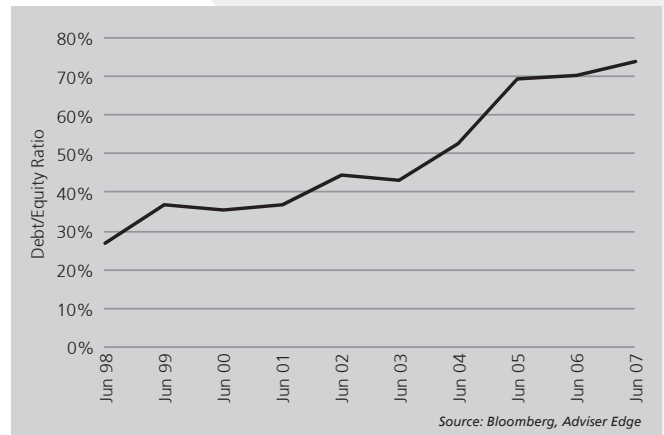
With the quick dissolution of the once liberal lending environment into an unexpectedly tight credit market, it has become increasingly important to examine the short term debt obligations of companies as well as their longer term capital structuring when assessing their viability and risk profile going forward.

Those listed property trusts with debt facilities expiring in the short term are likely to under perform significantly during 2008, as negotiations to rollover such debt may result in largely inflated interest costs going forward or withdrawal of lending altogether forcing asset sales to avoid insolvency.

Gearing (Median)



Debt to Equity (Median)



The Year Past

Historically the attractiveness of the listed property asset class to investors has been greatly bolstered by its reputation for consistency coupled with its moderate to high performance. However, despite strong fundamentals giving buoyancy to the domestic direct property market throughout 2007, the listed market behaved with very little correlation to the performance of its underlying assets.

While accounting measures have distorted the ability to compare many ratios to their historical values, the trend of rising yields and falling price to earnings multiples suggests that many property related stocks may be trading at a significant discount. Further to this point we are beginning to see yields of the listed market, especially within the office sector, providing for incomes higher than that of direct asset counterparts.

LPTs, the Horse Before the Cart?

The notion that listed property has acted as a leading indicator for the direct market then presents itself as a possibility. While historically, performance of the underlying real assets has dictated the favour given to property trusts and entities listed on the ASX, it may now be that the efficiency and frequency of stock transactions has pre-emptively shown a softening of direct property fundamentals. With a forecasted slowdown of both the domestic and global economy on the horizon, and a technical recession of the US slated to occur, the outlook for Australian direct property is still positive overall albeit significantly subdued compared to its 2007 performance.

In the same way futures markets reflect the expected outlook of underlying assets, the rising yields of the listed property market can be seen as reflecting a likely stabilisation and subsequent rise of capitalisation rates for 2008 and 2009 transactions of direct property within Australia.

Given the fallout in investor confidence, and uncertainty relating to the debt market, it is likely that the worse may still be to come for both domestic and global listed property. The erratic movements of listed property may have been avoided had investors been more prudent with their analysis and stock picking, rather than blindly riding the strong bull market of late 2006, early 2007.

2008 to Reward Prudent Investors

It is expected that listed trusts with sound fundamentals and strong asset portfolios will undoubtedly out perform during mid to late 2008. With higher weighting given to the analysis of corporate governance and capital structure metrics going forward, investors should be able to greatly reduce their downside risk while reaping the benefits of an eventual market recovery.

Given the uncertainty of the market on the whole however, and a fallout in the stability traditionally offered by giving bias to large market capitalisation stocks such as Centro, it would be perhaps unwise to simply "buy the index". While during 2005 and 2006 active management saw little value being added to portfolios, with the ASX Property Index booming as a whole, it is likely that in the current environment those able to make good picks on a stock by stock basis will see much greater rewards for their efforts.

The as discussed effect of debt structure especially relating to short term liabilities on a stocks risk profile, as well corporate governance considerations, form good starting points for the construction of a strong selective portfolio. These metrics however must be accompanied by both technical analysis, as well as fundamental analysis of the real assets behind those property trusts listed on the ASX. While considered "domestic", it is often the case that these trusts have exposure, either directly or indirectly, to international assets. Those with significant US exposures are likely to under perform going forward.

With the above considered, the potential for out performance is perhaps greatest for the office segment of the Australian listed property market, currently boasting the highest yields and lowest price earning multiples of the three major unstapled sectors. Moderate capital and rental growth is expected throughout 2008 and 2009, with this sturdy fundamental base likely to support out performance of low to moderately geared and soundly managed office trusts – especially those with a bias towards east coast CBD holdings.

Stapled Property Securities		14th January 2008			Financial Ratios (FY2007)				Total Returns (CY2007)		
ASX Code	Name	Current Yield	Price (\$)	Market Cap (\$)	Price/Earning	Debt to Assets	Debt to Equity	Payout Ratio	1 Year	Comp. 3-Year	Comp. 5-Year
Office											
IOF	ING Office Fund	6.6%	1.62	2,046.5	3.3	33.9%	54.8%	24.0%	12.9%	14.3%	14.8%
REU	Rubicon Europe Trust Group	16.2%	0.63	309.9	3.3	60.7%	201%	49.2%	-33.4%	-	-
Retail											
CER	Centro Retail Group	6.7%	0.95	2,172.1	2.4	54.2%	124.8%	27.4%	-49.8%	-	-
CNP	Centro Properties Group.	20.3%	1.01	853.6	1.7	44.1%	101.1%	70.6%	-86.6%	-34.7%	-13.4%
WDC	Westfield Group	5.1%	21.00	40,786.1	6.6	42.1%	87.0%	33.5%	5.1%	14.4%	-
Industrial											
GMG	Goodman Group	6.7%	4.89	8,388.7	12.8	42.1%	84.3%	82.6%	-31.3%	-	-
Diversified											
ABP	Abacus Property Group	7.4%	1.75	1,120.1	8.1	31.0%	49.1%	58.0%	1.9%	15.5%	18.4%
ALZ	Australand Property Group	8.4%	2.32	2,152.0	8.6	40.0%	81.8%	61.6%	26.1%	19.0%	22.3%
APZ	Aspen Group	6.4%	2.30	604.2	6.4	31.0%	50.2%	89.9%	35.3%	35.4%	35.3%
CHC	Charter Hall Group	4.8%	2.49	1,087.4	20.8	24.4%	34.4%	91.0%	15.5%	-	-
CMW	Cromwell Group	9.4%	1.09	769.6	87.9	45.3%	87.2%	0.0%	3.7%	72.0%	-
DRT	DB RReef Trust	5.8%	2.00	5,864.1	12.8	35.3%	58.8%	72.7%	19.2%	22.4%	-
FKP	FKP Property Group	5.8%	6.35	1,670.7	7.2	26.6%	74.2%	39.1%	2.1%	26.2%	43.8%
GPT	GPT Group	7.1%	4.04	8,482.4	6.0	35.8%	57.7%	30.6%	-22.8%	8.6%	12.8%
MFT	MFS Diversified Group	10.4%	0.86	364.8	11.6	44.6%	105.5%	142.8%	4.8%	7.6%	-
MGR	Mirvac Group	5.6%	6.00	6,165.2	10.2	34.7%	62.6%	56.2%	13.4%	14.6%	15.7%
MSAS	Macarthurcook Asian Real Estate Sec.	1.0%	0.50	-	-	-	-	-	-	-	-
SGP	Stockland	5.6%	8.42	12,213.6	6.8	28.1%	46.9%	36.3%	7.4%	18.7%	19.0%
TCQ	Trinity Group	5.0%	2.30	531.2	17.6	25.1%	37.2%	41.6%	27.0%	40.9%	-
TGP	Trafalgar Corporate Group	12.4%	2.05	175.0	-	40.7%	73.9%	-	-3.6%	-	-
THG	Thakral Holdings Group	6.7%	1.04	628.5	9.9	40.0%	73.7%	66.9%	18.1%	19.6%	19.4%
VPG	Valad Property Group	9.2%	1.29	1,966.3	8.1	15.2%	19.4%	74.7%	-11.1%	7.2%	14.1%
Specialist											
BBC	Babcock Brown Communities	4.6%	0.92	599.6	65.7	31.8%	175.5%	0.0%	-16.3%	-	-
BEC	Becton Property Group	7.7%	3.84	628.5	7.4	17.7%	46.2%	68.0%	39.3%	-	-
BLP	Babcock Brown Resi. Land Partners	11.3%	0.70	121.6	41.1	40.6%	85.9%	443.6%	-5.6%	-	-
CKP	Cheviot Kirribilly Vineyard Prop. Group	11.5%	1.47	19.7	75.4	35.7%	59.2%	419.1%	-4.8%	-	-
LEP	ALE Property Group	7.0%	3.90	355.3	3.6	60.0%	162.7%	30.2%	-1.6%	41.0%	-
MLE	Macquarie Leisure Trust Group	5.4%	3.49	766.6	15.0	23.2%	33.3%	76.0%	23.4%	32.9%	46.3%
MPY	MFS Living And Leisure Group	14.6%	0.70	125.7	29.0	52.8%	2584%	0.0%	-9.5%	-	-
Stapled											
	Median	6.7%		811.6	8.6	35.7%	73.8%	58.0%	2.9%	18.0%	19.8%
	Weighted Average	6.1%			8.9	37.6%	77.1%	45.4%	0.1%	17.1%	19.7%
Overall											
	Median	8.0%		534.1	6.4	36.1%	74.1%	40.3%	-0.8%	11.3%	14.6%
	Weighted Average	6.4%			8.1	36.4%	74.1%	43.4%	-0.1%	16.0%	18.4%

Source: Bloomberg, Adviser Edge

Unstapled Property Trusts		14th January 2008			Financial Ratios (FY2007)				Total Returns (CY2007)		
ASX Code	Name	Current Yield	Price (\$)	Market Cap (\$)	Price to Earnings	Debt to Assets	Debt to Equity	Payout Ratio	1 Year	Comp. 3-Year	Comp. 5-Year
Office											
CPA	Commonwealth Prop. Office Fund	6.1%	1.55	2,498.5	4.6	26.4%	39.0%	29.6%	11.5%	14.6%	13.4%
MAFCA	Multiplex Prime Property Fund	7.6%	0.62	174.7	2.9	60.3%	157.0%	21.4%	8.5%	-	-
MOF	Macquarie Office Trust	8.0%	1.40	2,841.0	2.9	27.9%	42.9%	23.0%	-1.8%	10.9%	11.2%
RNY	Reckson New York Property Trust	11.3%	0.68	179.1	3.7	0.1%	0.1%	35.0%	-32.4%	-	-
RRT	Record Realty	16.7%	0.66	263.5	2.3	79.7%	462.7%	0.0%	-15.9%	-	-
TSO	Tishman Speyer Office Fund	10.5%	1.63	557.4	1.9	36.1%	71.9%	22.1%	-27.9%	1.5%	-
WOTCA	Westpac Office Trust	6.5%	0.61	291.1	2.4	46.4%	88.4%	27.5%	10.2%	6.4%	-
Retail											
AEZ	APN/UKA Euro Retail Prop. Group	10.2%	1.00	541.9	4.5	45.4%	95.9%	39.1%	-7.4%	-	-
BWP	Bunnings Warehouse Property Trust	5.6%	2.34	705.4	3.4	26.8%	38.3%	18.9%	14.4%	15.2%	19.0%
CDP	Carindale Property Trust	5.7%	4.49	314.3	4.6	9.7%	11.1%	25.6%	-7.0%	21.5%	20.3%
CFX	CFS Retail Property Trust	5.1%	2.34	5,247.8	4.5	28.2%	41.9%	38.0%	5.5%	19.3%	17.8%
MCW	Macquarie Countrywide Trust	9.5%	1.65	2,203.3	4.2	20.3%	27.6%	40.3%	-14.4%	0.1%	8.1%
MDT	Macquarie Ddr Trust	13.0%	0.77	715.7	3.9	6.1%	7.8%	50.2%	-34.3%	-3.5%	-
Industrial											
IIF	ING Industrial Fund	6.9%	2.54	2,837.0	6.4	36.2%	60.4%	42.4%	14.6%	12.7%	16.5%
MIX	Mirvac Industrial Trust	13.9%	0.70	258.8	5.2	51.5%	128.1%	72.9%	-22.6%	-	-
OIF	Orchard Industrial Property Fund	5.1%	0.80	276.0	-	60.7%	206.0%	-	-	-	-
Diversified											
AUP	Aurora Prop. Buy-Write Income Trust	5.2%	9.00	-	-	-	-	-	-	-	-
BJT	Babcock Brown Japan Property Trust	8.9%	1.40	734.1	5.2	44.3%	102.4%	45.4%	-27.0%	-	-
CDI	Challenger Diversified Property Group	8.0%	1.00	537.0	8.7	25.8%	37.7%	47.8%	1.0%	-	-
CJT	CVC Trinity Property Fund	-	0.15	15.8	115.4	14.8%	0.0%	0.0%	-	-	-
EPF	Esplanade Property Fund	8.4%	0.19	37.3	-	0.0%	0.0%	0.0%	4.0%	29.6%	120.9%
GJT	Galileo Japan Trust	10.3%	0.77	312.3	6.6	50.3%	120.6%	33.8%	-19.9%	-	-
MPF	Multiplex Acumen Property Fund	9.1%	1.20	-	-	-	-	-	9.5%	12.7%	-
MPS	Macarthurcook Prop. Securities Fund	11.3%	0.88	-	-	-	-	-	-9.5%	2.9%	-
MRA	Mariner American Prop. Income Trust	13.3%	0.70	143.3	5.7	53.2%	130.7%	75.5%	-17.3%	-	-
MRZ	Mirvac Real Estate Investment Trust	8.0%	1.30	815.4	3.8	31.7%	48.4%	16.3%	0.0%	8.7%	11.3%
MUE	Multiplex European Property Fund	4.9%	0.90	222.3	-	-	-	-	-	-	-
RAB	ANZ Rabinov Property Trust	6.5%	1.70	81.9	5.3	69.2%	242.9%	25.2%	3.4%	23.3%	-
RAT	Rubicon America Trust	15.4%	0.74	300.2	2.2	72.0%	286.8%	30.8%	-25.8%	1.2%	-
RJT	Rubicon Japan Trust	12.9%	0.72	296.4	3.2	52.1%	138.0%	40.4%	-24.4%	-	-
WST	Westralia Property Trust	30.3%	0.32	26.9	-	57.4%	139.2%	153.1%	-16.6%	-13.7%	-
Specialist											
AEU	Australian Education Trust	9.3%	1.58	213.3	7.8	50.5%	113.2%	66.7%	-6.6%	14.2%	-
CNR	Coonawarra Australia Property Trust	8.0%	0.60	10.5	12.0	31.3%	51.8%	103.8%	13.7%	-2.2%	-
CWT	Challenger Wine Trust	12.3%	0.74	126.0	14.7	44.4%	84.5%	181.9%	-7.6%	0.4%	6.3%
IEF	ING Real Estate Entertainment Fund	8.1%	1.23	202.0	3.3	56.8%	139.5%	26.4%	13.1%	10.2%	-
IHF	ING Real Estate Healthcare Fund	7.8%	1.10	54.9	6.4	59.2%	172.2%	55.8%	13.6%	-	-
ILF	ING Real Estate Community Living	9.1%	1.22	530.8	4.5	25.0%	43.6%	42.2%	5.2%	9.4%	-
PTN	Prime Retirement Prop. Trust	3.4%	0.88	484.6	-	24.6%	75.2%	0.0%	-	-	-
TPF	Timbercorp Primary Infrac. Fund	10.3%	0.99	54.4	6.4	-	-	-	-1.7%	-	-
Unstapled											
	Median	8.6%		293.7	4.5	40.2%	79.8%	35.0%	-4.2%	7.2%	11.3%
	Weighted Average	7.7%			4.6	31.6%	62.0%	35.3%	-1.0%	11.1%	14.0%
Overall											
	Median	8.0%		534.1	6.4	36.1%	74.1%	40.3%	-0.8%	11.3%	14.6%
	Weighted Average	6.4%			8.1	36.4%	74.1%	43.4%	-0.1%	16.0%	18.4%

Source: Bloomberg, Adviser Edge

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