

QUEENS RIVERSIDE Q

ECONOMIC OUTLOOK REPORT INNER PERTH APARTMENT MARKET, FROM A NATIONAL PERSPECTIVE

Prepared by Macroplan for Frasers Property Australia, 2011

MacroPlan Australia
Setting New Standards



ABOUT THE RESEARCHER: MACROPLAN

MacroPlan Australia was established in 1986 to meet market demand for a high quality land use planning, economic research and property advisory consultancy. MacroPlan is nationally based, with offices on both the eastern and western seaboard.

MacroPlan's staff are well versed in national and local issues relevant to property development. Our unique combination of economic analysis and an understanding of town planning assumptions and processes enables MacroPlan to handle a broad range of project requirements – from demographic forecasting, social and economic impact assessments, employment land needs analysis, retail and commercial impact assessments, development staging and approvals, land rezonings, infrastructure funding and market analysis across all property sectors.

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NATIONAL ECONOMIC OUTLOOK

The prospects for national economic growth remain very solid. Major construction projects for the mining and energy sectors represent key drivers for economic activity.

To achieve this investment boom, there will be increasing demand for skilled workers in the construction and project management sectors. Jobs growth in these sectors is expected to push the unemployment rate down below 5%.

By itself, the construction boom will create upward pressure on interest rates. This force was last evident during 2008, when standard variable housing interest rates briefly moved above 9.5%. At that time, national unemployment was close to 4%.

Housing interest rates are currently marginally above the average for the past decade, and the prospects of rate hikes will determine the path for residential property markets over the next three years. Our view is that the next peak in interest rates will be closer to 8.5% than 9.5%.

Some key sectors are expected to show weakness over the next two years, which would alleviate the need for rate hikes.

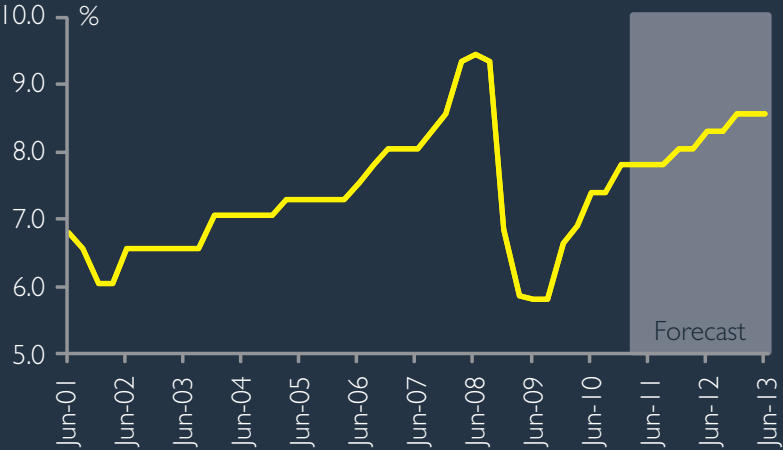
Trends in the retail sector will have a major bearing on the prospects for housing interest rates. The retail sector accounts for about one-quarter of national employment. Recent evidence shows that retail spending has slowed considerably over the past year, even though jobs growth has been solid. In general, households have become more cautious, limiting debt and increasing savings. A weaker profile for retail sales will tend to limit jobs growth, and thereby reduce upward pressure on interest rates.

National building activity, covering the residential and non-residential sectors, represents another important driver for jobs. National building activity is expected to be subdued over the course of 2011 and 2012. Residential building in New South Wales and Queensland remains weak by historical standards, being constrained by relatively high land prices. Non-residential building refers to commercial building (such as offices and shops) and government activity (such as hospitals and schools). Government stimulus spending for schools is now winding down, and developer investment on major commercial projects is being constrained by cautious lenders.

If housing interest rates do peak at about 8.5% over the next three years, then we expect that residential property prices can achieve moderate increases. During the last interest rate cycle, residential property markets were substantially dampened once interest rates moved above 9%.

With a peak in variable housing rate peak of about 8.5%, local market conditions are expected to be relatively important. Demand and supply drivers in each residential property market will develop, and generate different outcomes across the capital cities. Perth residential property is well placed to perform relatively well, as affordability is reasonable and the market is expected to tighten considerably.

FORECAST FOR VARIABLE HOUSING INTEREST RATES



Source: RBA, MacroPlan

WA ECONOMIC OUTLOOK

Over the past two years, growth in the Western Australian economy has moderated. The primary support has come from the strength of mining investment, export incomes and the improving performance of the contractor services sector. However, expansion of household spending and investment has slowed. The key feature is the relative weakness of employment growth, which remains below the peak rates observed from 2005 to 2008. Consequently wages growth has stabilised to about 3.5%, down from the peak levels of 5% in 2007 and 2008.

The investment drivers are already in place for the next phase of WA's strong expansion. Most of this increase will be focused on the burgeoning oil and gas segment, with massive LNG projects now ramping up. But there will also be a large increase in mine, port and rail construction through the next few years aimed at boosting iron ore exports given robust growth in global demand (industrial production) and high commodity prices.

Based on the stated objectives of leading locally-active mining companies for major projects, the current round of mining investment is expected to peak in 2013-14, with the main impetus to growth seen over 2011-12 and 2012-13. We suspect that the miners may well be over estimating the amount of work they can get through in any given year, due to capacity constraints. Capacity constraints are likely to push out the peak in aggregate work to 2015. Beyond 2015, activity may moderate, but the average annual volume of work is expected to remain higher than the level observed in 2010, so there is not expected to be a slump in economic activity.

Confidence, both for consumers and businesses, will lift as mining investment, exports and incomes stimulate broader employment, profits and investment growth over 2012 and 2013.

It is estimated that WA private and public sectors will invest in excess of \$100bn in new infrastructure projects over the next 5 years.

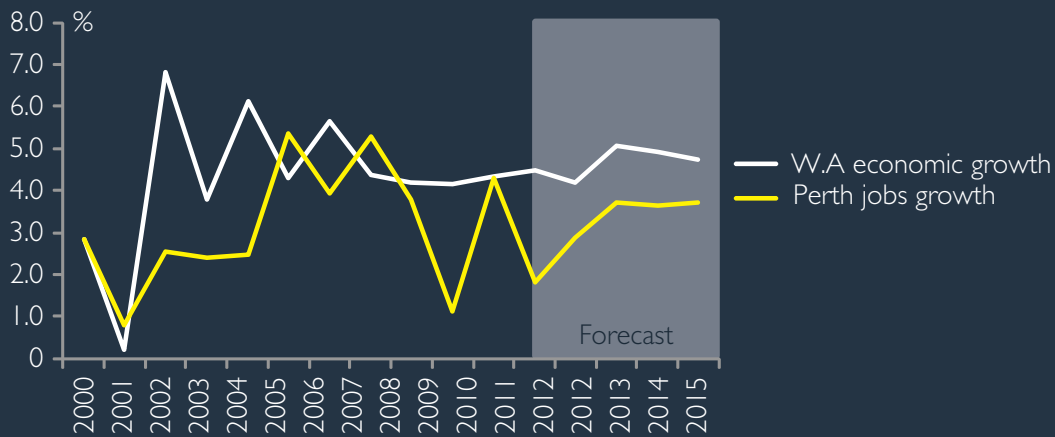
In this environment, the labour market should tighten, so that unemployment moves back below 3% and wages growth will accelerate again.

The recent experience during 2008 and 2009 shows that there are risks to the state's economic outlook, particularly if global growth were to be interrupted by further economic shocks. However, if there was to be a downturn in mining sector investment beyond 2015, there would be countervailing policy moves to support the Western Australian economy.

The Western Australian government will be in a position to accumulate very large budget surpluses over the next few years, drawing on mining royalties. Those savings should permit ample stimulus expenditure in the event of an unexpected sharp downturn in mining construction. Furthermore, this environment would enable the RBA to cut interest rates, thereby supporting housing demand.

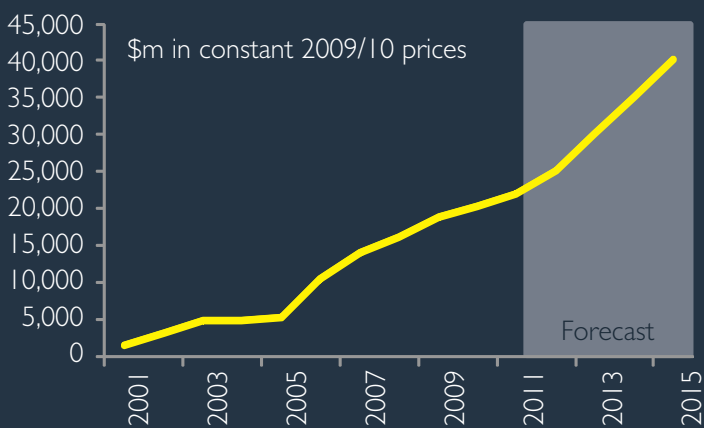
We expect that Perth's housing market will tighten progressively over the next three years, so that any future easing of interest rates would create a substantial boost to residential sales and building activity. In summary, there will be policy support for the local economy in the event of an extended slowing of mining construction activity.

FORECASTS FOR GROWTH IN ECONOMIC ACTIVITY AND PERTH JOBS



Source: ABS, MacroPlan

FORECASTS FOR EXPANSION IN WESTERN AUSTRALIA ENGINEERING CONSTRUCTION ACTIVITY



Source: ABS, MacroPlan

PERTH OVERSEAS MIGRATION AND CBD JOBS GROWTH

Overseas migration has been a critical source of workers for Perth over the past five years. Shortages of skilled workers across Australia have limited the scope for interstate migration to fill vacant positions.

Most of the overseas migration to Perth has been managed through temporary worker visas. These workers tend to live in rental properties, and thereby exercise considerable force in the rental market. Most recently, net overseas migration to Perth has diminished from a peak of about 38,000 persons in calendar 2009 down to about 32,000 persons last year. This decrease is consistent with the slowing of jobs growth across the city.

As the labour market tightens again over the next three years, overseas workers will need to fill job vacancies, so that net overseas migration increases again. This source of population growth will continue to feed primarily into the rental market, which will lead to a rapid tightening of the residential vacancy rate across the city.

Over the past five years, the expansion of the CBD workforce was fairly small compared to the overall jobs growth in Perth. From 2005 to 2010, total jobs growth in Perth averaged 30,000 persons per annum. We estimate that the CBD component of the total employment increase was about 8%. In the eastern capital cities, CBD office workforce growth averaged about 12% of total workforce growth during the 2005-2010 period, so the contribution in Perth was somewhat lower than the national average.

This situation partly reflects the predominance of construction and mining sector employment in Perth. There has been a substantial increase in the number of workers who are travelling to construction projects located in the mining and energy regions of the state.

It also reflects the lack of office space back in 2007 and 2008, when jobs growth was very strong. Over the four years to 2008, there was total of 40,000m² of new office space constructed in the Perth CBD. The scope for higher employment growth in the Perth CBD is now far greater, due to the construction of new office towers. New buildings will add about 300,000m² over the four years to 2012. In turn, the potential for more office workers will mean that underlying demand for inner city apartments should be greater than it was in the past economic cycle.

The sectors that drive demand for CBD office space tend to be professional and technical services, financial and insurance and public administration (government sector). Jobs growth in these sectors has been dominated by professional and technical services, in the form of contractor and consultancy services for mining and energy projects.

The upturn in mining and energy project investment is expected to persist over the long-term. Investment through construction projects will increase production capacity within the sector, supporting CBD employment growth in Perth.

The following chart illustrates the projected net effect of BHP investment on iron ore production by that company in Western Australia. Over the ten years to 2020, a given level of investment (represented by the yellow band) is forecast to increase production capacity by about 10% per annum. This will be achieved through investment in input resources, including labour and machinery.

There is considerable scope for strong expansion of CBD employment, as supply of office space is currently rising substantially. These completions will allow some businesses to consolidate their workforce in the CBD, and that will lead to higher demand for inner city apartments.

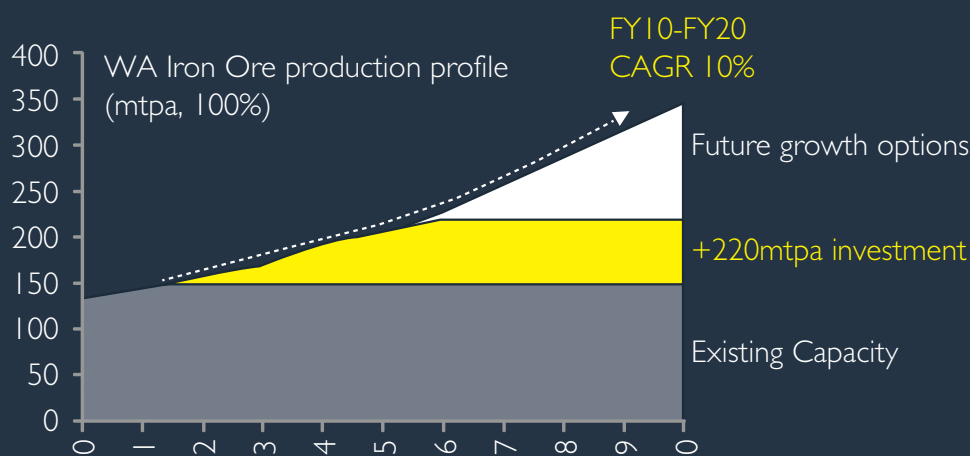
Demand for incoming Perth office supply is already strong. BHP is expected to anchor the City Square tower, committing to an additional 61,500m² of office space in Perth.

Price Waterhouse Coopers has also agreed to lease office space within the same 125 St Georges Terrace premises (8,500m²). Despite an estimated completion date of late 2011, total pre-completed lease space for this tower has surpassed 90%. This represents a good litmus

test for Perth office space.

We expect that CBD employment will show very strong growth over the next five years, as the broader services sector seeks to leverage off construction investment projects planned by mining and energy companies. This high level of investment is attracting service providers into Perth, most notable investment banking and law firms. Recent examples include law firms Allen and Overy, Clifford Chance, Maurice Blackburn and Moray and Agnew, and investment banks UBS and Bank of America-Merrill Lynch.

BHP MARCH 2011 PROJECTIONS OF WESTERN AUSTRALIA IRON ORE PRODUCTION

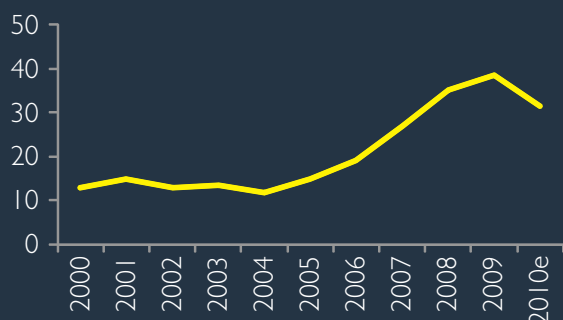


Source: BHP Billiton Analysis

Note: CAGR refers to Compound Annual Growth Rate.

All studies and estimated capacity remain under review until they are approved for execution.

NET OVERSEAS MIGRATION TO PERTH ('000'S PERSONS PER ANNUM)



Source: ABS, MacroPlan Australia

WA HOUSING DEMAND AND SUPPLY

Dwelling starts in Perth have fallen over the twelve months to Dec 2010, dropping back to the low recorded in 2008/09. Sales of new detached houses have decreased substantially, reaching a ten-year low in calendar 2010.

Demand from the key segments of first home buyers and upgraders has declined. First home buyer demand was very strong during 2009, as low interest rates and the First Home Buyer (FHB) incentive schemes combined to sustain sales. After the FHB Boost scheme ceased at the end of 2009, first home buyer demand fell sharply. First home buyer purchases were down 56% in 2010.

Upgrader numbers also fell substantially in 2010. As fewer first home buyers acquired older, more affordable properties, lower turnover meant that there were fewer upgraders in a position to buy a new house.

Investor demand for new apartments was also low in 2010. Perth's residential property market was not generating compelling evidence to sustain investor interest. At the start of 2010, Perth's rental vacancy rate was comparatively high at close to 4%. In addition, price growth was modest during 2009 and 2010 averaging 4% per annum, compared to 11% in Sydney and 15% in Melbourne. The consequence was that commencements of new inner Perth apartments were very low at just 600 units in 2010.

The market will tighten from here. The overall position is that aggregate Perth housing supply will be falling in 2011 and 2012. Due to softer population growth, demand for new dwellings is also moderating, but our analysis indicates that it remains above annual supply.

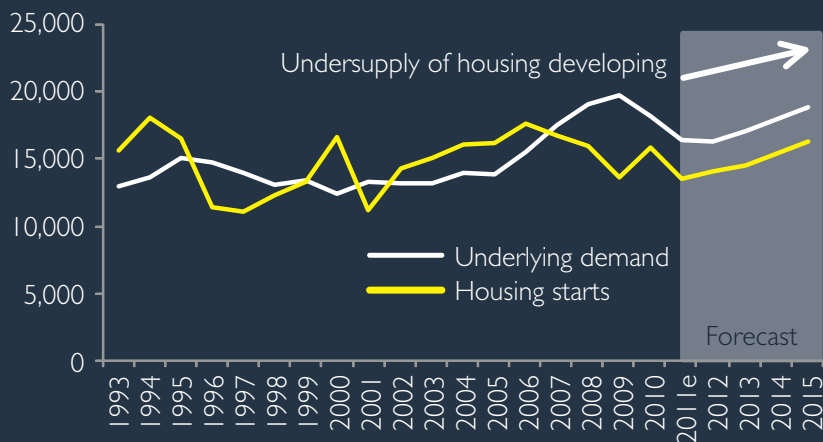
Underlying demand for new dwellings is projected to diminish from a peak of 20,500 in 2009 to about 16,600 in 2011. Perth housing starts are expected to be about an average of about 13,500 in 2011 and 2012, which would mean that underlying demand exceeds supply by 3,100 dwellings per annum from 2011.

There is already some initial evidence that the overall residential market is tightening. Perth's rental vacancy rate has decreased from about 4% at the start of 2010 to be just over 3% by the end of last year. With underlying demand remaining higher than new supply, the rental market should continue to tighten over the next two years.

We expect that the city's vacancy rate will move below 2% by the middle of 2012.

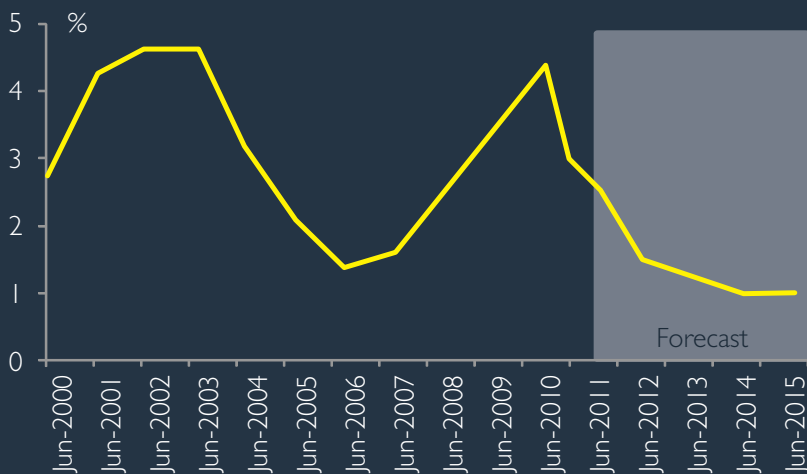
In conjunction with a tightening rental market, there will be support from household income growth. As Perth's unemployment rate moves back down to about 3%, wages growth should accelerate in 2011 and 2012, rising to about 5%. This expansion will tend to buoy demand for residential property.

DEMAND AND SUPPLY FOR NEW DWELLINGS IN PERTH



Source: ABS, MacroPlan Australia

PERTH RESIDENTIAL VACANCY RATE



Source: REIA

WA HOUSING AFFORDABILITY

Our measure of housing affordability assesses mortgage repayments for a median priced house, using the prevailing variable housing rate. These outlays are compared to the average disposable income for households in Western Australia.

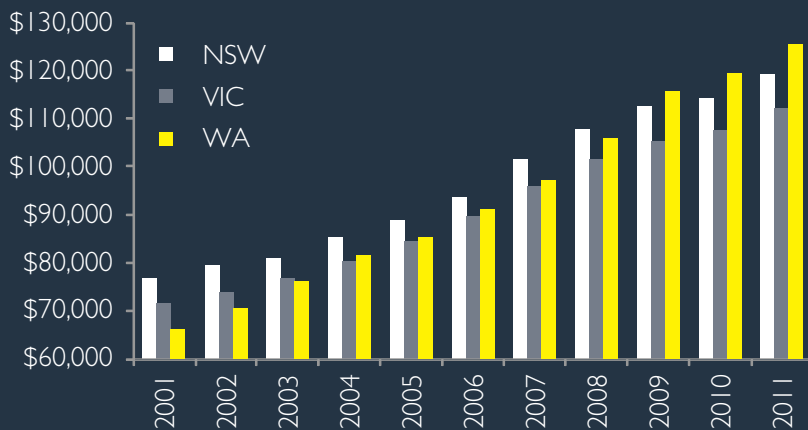
Our analysis indicates that housing affordability in Perth is currently far better than in Sydney or Melbourne. Over the past two years, house price growth in Perth has been more moderate than in Sydney or Melbourne. But over the same period, growth in household disposable income was significantly higher in Western Australia than in the eastern states.

A combination of moderate house price growth and solid income growth has resulted in a steady path for housing affordability in Perth, in contrast to the deterioration in Sydney and Melbourne.

On the basis of current affordability, there is greater scope for property price growth in Perth than in the eastern capitals.

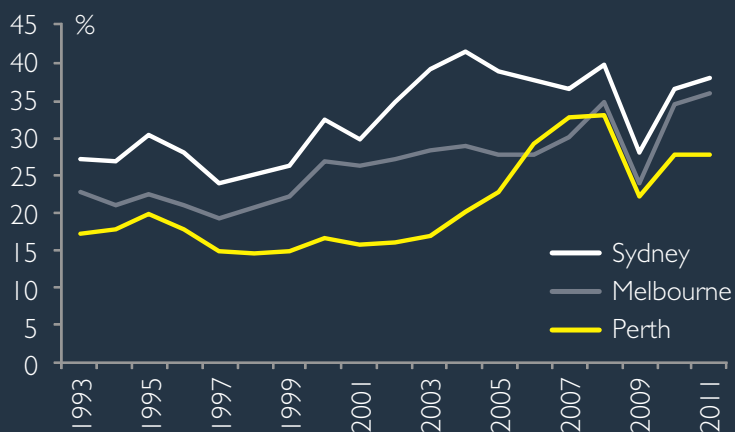
In conjunction, household income growth is expected to remain above the national average, due to the broadening economic impacts from the mining construction cycle and the projected investment in private and public infrastructure projects over the next 5 year period.

AVERAGE HOUSEHOLD INCOME



Source: ABS, MacroPlan Australia

HOUSING AFFORDABILITY MEASURE



Source: REIA, RBA, MacroPlan Australia

Note: Housing affordability is estimated as mortgage repayments as a share of average household disposable income. Repayments are calculated on a mortgage value that is equivalent to 75% of the median house price, applying the standard variable housing rate.

INNER PERTH APARTMENTS — DEMAND AND JOBS GROWTH

Demand for inner ring apartments was resilient during 2007 and 2008, in contrast to a softening market for established houses. Prices for inner ring apartments continued to rise in 2007 and 2008, but house prices declined. This pattern was also reflected in dwelling construction, with approvals for high density housing expanding rapidly in 2007 and 2008.

The resilience of demand for apartments at that time was partially due to strong growth in corporate profits in Perth. The mining boom led to very large increases in business profit margins from 2006 to 2008. This trend is reflected in the next figure which shows aggregated growth of Western Australian private sector profits (as indicated by the national accounts measure for gross operating surplus).

This relationship indicates that non-wage incomes were booming in 2007 and 2008, and this fuelled apartment demand from company owners and managers – at a time when lower to middle income earners were having disposable income eroded by high interest rates.

Slowing growth in corporate profits occurred during 2009 and 2010, as the Global Financial Crisis led to cancellation of commercial building projects, and the deferral of some mining construction work. Consequently, demand for new apartments and higher value established units decreased.

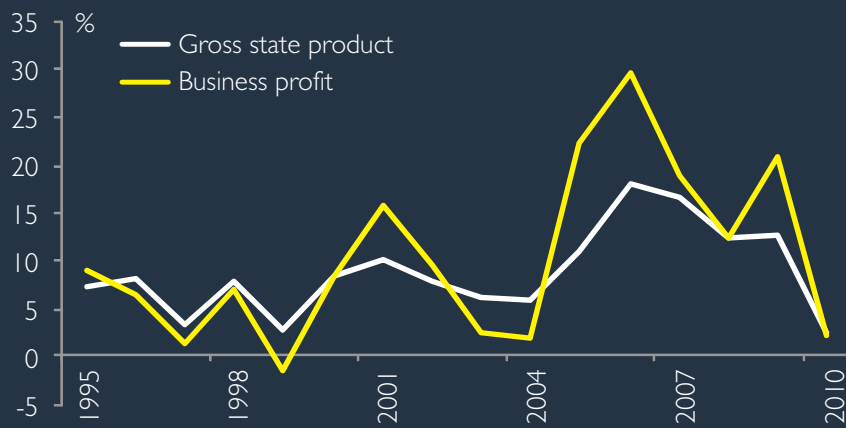
The FHB incentive scheme did support demand for more affordable units, which meant that sales did recover in 2009 (and pushed down the median price of sales). In 2010, sales of inner ring apartments have moderated again, due to the decline in FHB demand. In addition, the improvement in corporate profitability is yet to come through, which is constraining demand.

Looking forward, we expect that profit growth will recover strongly from 2011 to 2013, initially due to the demand for construction contractor and professional services supplied into the mining sector, which are based out of Perth.

CBD jobs growth will raise the underlying demand for inner city rental properties. The unemployment rate in Perth is now 4.4% (compared to below 3% prior to the GFC), so there is scope for CBD employment growth to develop again in 2011 and 2012. There are large volumes of office space to be completed. These completions will allow some businesses to consolidate their workforce in the CBD, and that will lead to higher demand for inner city apartments.

Consequently, we think that underlying demand for inner Perth apartments will average about 1,200 dwellings per annum in 2011 and 2012.

WESTERN AUSTRALIAN ECONOMIC GROWTH DRIVES BUSINESS PROFIT GROWTH



Note: Business profits as estimated by gross operating surplus in ABS State Accounts
Source: MacroPlan Australia (2010).

INNER PERTH APARTMENTS — SUPPLY AND RENTAL GROWTH

Rental growth for units in East Perth was very strong during 2007 and 2008. The CBD office workforce expanded rapidly in those years, and the rate of new apartment construction was modest, so the rental market was very tight.

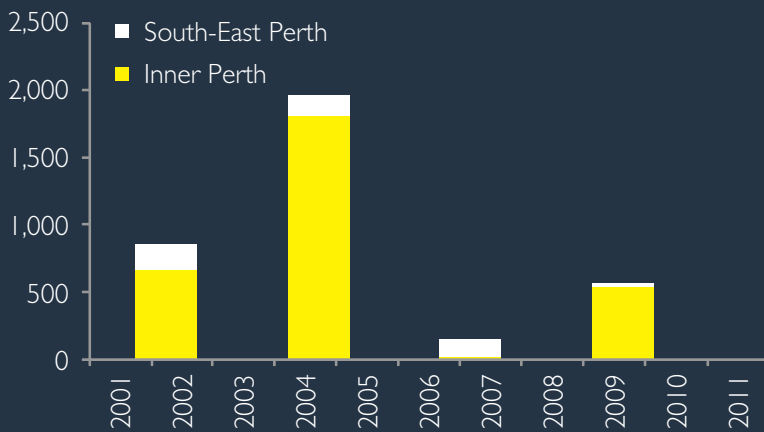
There was a slowing of jobs growth during 2009, which led to softer demand for rental properties. In 2010, the rate of supply improved, as apartments commenced in 2007 and 2008 were completed. These conditions have resulted in levelling out of East Perth rentals over the past two years.

The rental market is set to tighten, due to relatively low levels of supply over the next two years. The last peak in building approvals was in 2008, when 1,819 apartments were approved for the inner Perth region. Dwelling approvals in inner Perth decreased substantially in 2009 (just 19 apartments) and 2010 (533 apartments) compared to the high levels of 2008. Our analysis indicates that there are few apartments left unsold from projects approved in 2008.

In terms of new projects, our analysis indicates that there are about 1,000 new apartments that may be marketed during 2011 or 2012 (which includes 265 residences at QIII). Considering that demand for new apartments is set to recover and rise to around 1,000 new dwellings per annum, there appears to be a clear undersupply developing within the inner city area.

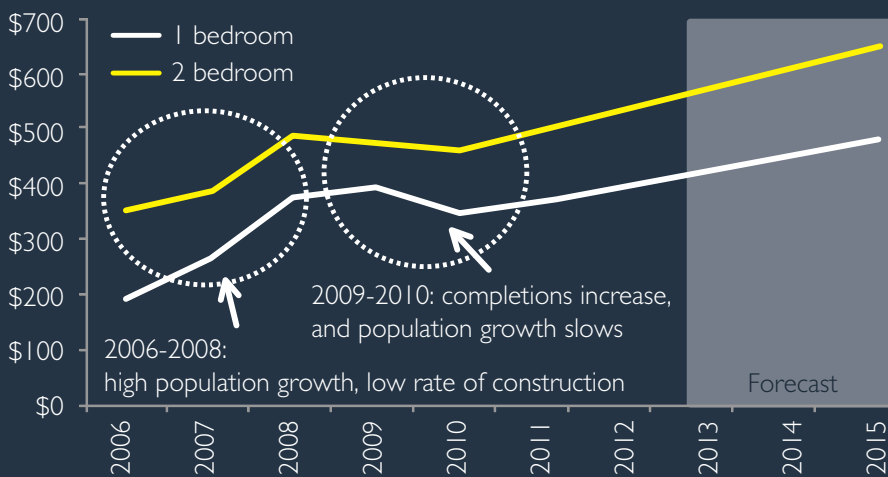
As the supply of completed apartments subsides during 2011 and 2012, we expect that rental growth will recover. Inner city rental growth is projected to average 7% per annum over the four years to 2015.

INNER PERTH APARTMENT APPROVALS (NUMBER OF DWELLINGS)



Source: ABS, MacroPlan

MEDIAN RENTALS FOR INNER PERTH APARTMENTS



Source: REIWA

INNER PERTH APARTMENTS — PROJECTED PRICE GROWTH

Overall Perth house prices showed annual compound growth of 7.6% over the five years to December 2010. Inner Perth apartments showed a higher growth rate of 8.6% per annum. The rate of increase in house prices was marginally above the 7.0% growth in average household disposable income across Western Australia over the same period. Consequently, our view is that the prospects for household income growth will continue to define the potential for long-term price growth.

We expect that wages growth will average 5% per annum over the next five years, as the labour market tightens and the unemployment rate shifts down towards 3%. Wages growth averaged 5% over the three years to 2008 (prior to the dampening effects of the Global Financial Crisis).

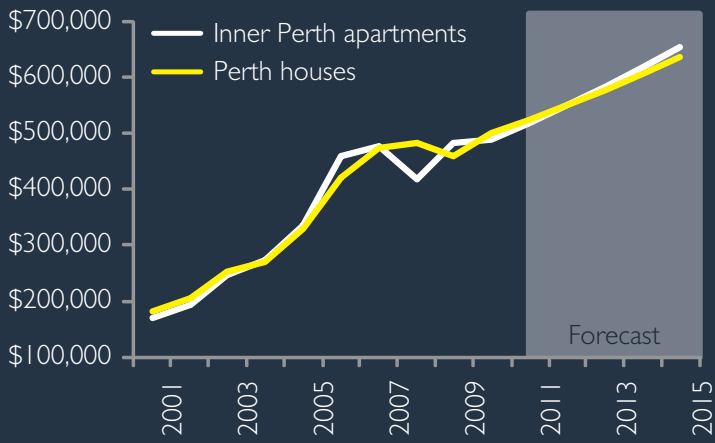
Strong wages growth will set the foundation for solid residential property price growth. In addition, the degree of tightness in the housing market should also have some effect. Given our view that the overall Perth rental vacancy rate will move below 2% by the middle of 2012, and generate strong rental growth, there should be some stimulus to investor demand.

For the inner Perth apartment market, there should be some downstream effects from a resumption of strong profit growth and the related expansion of the CBD office workforce. These factors will raise the potential price growth for inner city apartments above the overall trend for the housing market.

Overall, we project that inner Perth apartments can show average annual capital growth rate of 6% per annum from 2011 to 2015.



MEDIAN PRICES FOR HOUSES AND INNER PERTH APARTMENTS



Note: Inner Perth defined as combined Perth and South Perth local government areas
Source: RP Data, MacroPlan

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