

TAG Asset Consulting Group Pty Ltd
ACN: 097 703 047
AFSL: 230846
Trading as

ATCHISON CONSULTANTS

Benefits of Investing in Australian Residential Property

November 2009

Level 3, 155 Queen Street
Melbourne, VIC 3000
Phone: 03 9642 3835
Fax: 03 9642 8886
Mobile: 0425 754 731
E-mail: ken@atchison.com.au
www.atchison.com.au

Contents

Executive Summary	2
1 Australian Residential Property Market.....	3
1.1 Market Size	3
1.2 Ownership	3
1.3 Demand Drivers	4
1.4 Supply drivers	8
1.5 Vacancy Rates and Rental Growth	12
1.6 Summary	13
2 Investing in Residential Property	14
2.1 Historical Long Term Performance	14
2.2 Residential Property versus Major Asset Classes and Property Sectors.....	15
2.3 Investment Horizon.....	17
2.4 Summary	17
3 Australian Residential Property in Investment Portfolios	18
3.1 Correlations with Major Asset Classes	18
3.2 Australian Residential Property as Part of a Portfolio	19
3.3 Summary	20

Executive Summary

The estimated value of Australian residential property is \$3.5 trillion of which approximately 70% is owner-occupied with the remaining 30% rented, primarily private rental. The more populous states of New South Wales, Victoria and Queensland account for the majority of Australia's housing value.

Factors that influence demand for residential property include housing affordability, social trends, regulatory constraints and demographics. Supply drivers include construction, building approvals, financing levels and existing housing stock.

Currently there are historically low vacancy rates for rented dwellings in capital cities reflecting the impact of the combination of rapid population growth and inadequate supply of new housing. Increasing demand for rental accommodation and falling rate of growth of supply has resulted in significant growth in rents since 2005.

Australian residential property has generated consistent strong total returns over the long term. Income returns are stable but low compared with commercial property. Residential property should not be viewed as a yield investment but rather viewed as relatively low income producing assets with the potential for significant capital gains.

When compared with other asset classes over 10 and 20 year periods to 30 June 2009 residential property has produced total returns that are either equal to or higher than the major asset classes. The volatility of total returns is significantly lower than other growth assets such as listed property and shares.

Performance of residential property is not uniform throughout Australia indicating there is potential to invest in areas that may significantly outperform others and the national average.

1 Australian Residential Property Market

The following is a broad overview of the Australian residential property market, and factors which influence supply and demand within and around the property market.

1.1 Market Size

The residential property sector is the largest property sector in Australia with an estimated value of \$3.5 trillion comprising 8.9 million dwellings, as illustrated in Table 1. At a state level the value and growth of the housing market is closely linked with population.

Table 1 – Size of the Australian Residential Property Market – as at 30 June 2009

	Number of houses	Total Residential value (\$m)	Number of units*	Total Residential value (\$m)	Total Number of Dwellings	Total Residential value (\$m)
NSW	1,943,529	\$878,438	866,050	\$311,858	2,809,579	\$1,190,296
VIC	1,682,276	\$647,597	519,991	\$186,888	2,202,267	\$834,485
QLD	1,349,089	\$555,951	426,507	\$140,945	1,775,596	\$696,896
SA	562,570	\$176,882	149,174	\$39,773	711,744	\$216,655
WA	727,009	\$309,453	191,273	\$67,385	918,282	\$376,838
TAS	193,925	\$54,295	30,879	\$7,283	224,804	\$61,578
ACT	111,823	\$50,868	41,388	\$16,171	153,211	\$67,039
NT	49,470	\$23,968	28,105	\$9,998	77,575	\$33,965
Australia	6,619,691	\$2,697,452	2,253,367	\$780,301	8,873,058	\$3,477,753

*Includes Flats & Townhouses

Source: Atchison Consultants, REIA, ABS

The more populous states of New South Wales, Victoria and Queensland account for the majority of Australia's housing value. Western Australia's house numbers and value has increased as a result of the demand driven by the resource boom.

1.2 Ownership

Of the estimated value of Australian residential property of \$3.5 trillion, approximately 70% is owner-occupied and evenly divided between those with and without mortgages as illustrated in Table 2. The remaining 30% of the market consists primarily of private rental with a small contribution provided by Government sponsored affordable housing. The rental market proportion of 30% represents approximately \$1.05 trillion in value of which the majority is owned by individual investors.

The rented sector consists of around 18% State or Territory housing authority accommodation with the remainder private dwellings managed directly or by real estate agents.

Table 2 - Housing Tenure - Occupied Private Dwellings

Tenure type	2006	2006	2001	1996
	No	%	%	%
Fully owned	2,667,942	35.1	41.8	42.5
Being purchased	2,635,587	34.7	27.8	26.5
Rented	2,221,915	29.3	29.0	29.8
Other Tenure	70,741	0.9	1.5	1.0
Total	7,596,186	100.0	100.0	100.0

Source: ABS 2006 Census, Atchison Consultants

As shown in table 2 the rental proportion of the market has remained stable over the past 10 years. Table 3 shows the state breakdown of tenure for occupied private dwellings.

Table 3 - Tenure for Occupied Private Dwellings, States and Territories

	NSW	Vic	Qld	SA	WA	Tas	NT	ACT	Australia
Fully owned	35.9%	37.2%	32.8%	35.8%	32.7%	38.9%	19.5%	30.3%	35.1%
Being purchased*	32.6%	36.4%	33.8%	35.6%	38.0%	34.2%	31.1%	39.0%	34.7%
Rented [^]	30.7%	25.6%	32.3%	27.2%	28.2%	26.0%	48.3%	30.2%	29.3%
Other tenure type	0.9%	0.8%	1.1%	1.4%	1.1%	0.8%	1.1%	0.5%	0.9%

* includes being purchased under rent/buy scheme

[^] includes rent-free

Source: ABS 2006 Census

Of the states and territories, Victoria and Tasmania have the highest proportion of owner occupied dwellings while Northern Territory has the highest proportion of rented dwellings (48.3%).

1.3 Demand Drivers

There are several factors that influence demand for residential property. They include housing affordability, social trends, regulatory constraints and demographics.

1.1.1 Population growth

As the population grows, the supply of housing must keep pace with demand for prices to remain relatively constant. However, a simultaneous reduction in household size with a larger population will drive up the number of households in search of residential accommodation. Australia's population is forecast to grow from around 21.4 million in 2008 to 27.2 million in 2026¹, a 27% increase over the period. The number of households in Australia is projected to increase from 8.0 million in 2006 to 10.2 million in 2026², an increase of 28% over the same period. By implication, average household size is forecast to decrease from 2.6 persons per household to 2.4 persons. This suggests that demand for residential accommodation will remain strong in years to come.

¹ "Population Projections, Australia, 2006 to 2101" ABS – June 2009

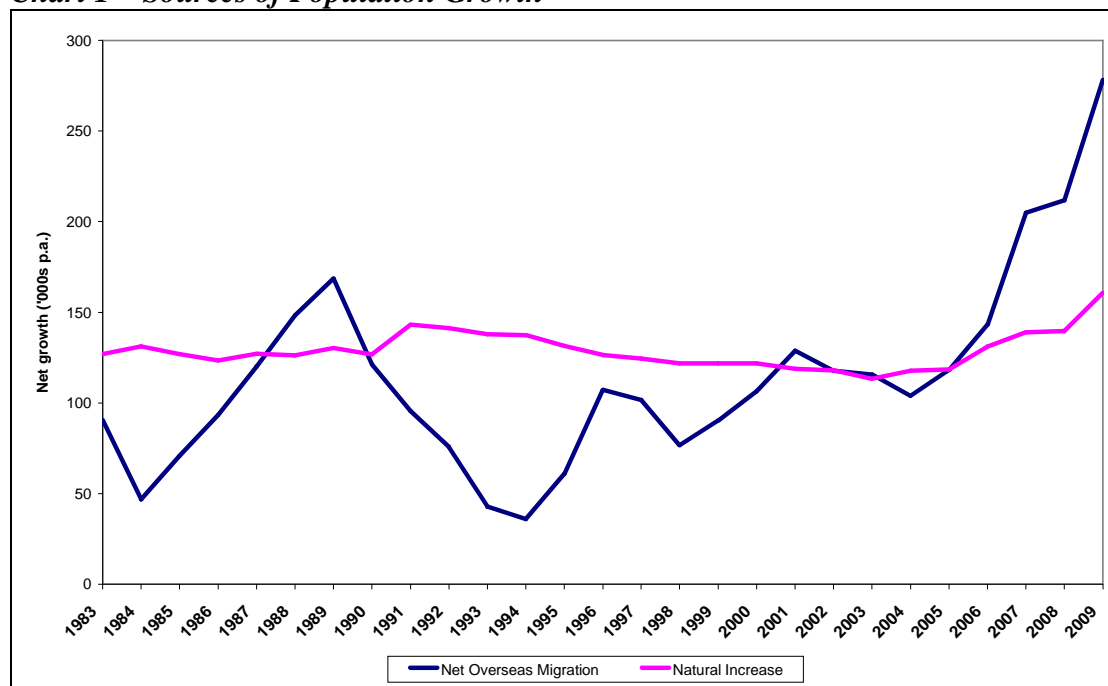
² "Household and Family Projections; Australia 2001-2026" ABS – June 2004

Table 4 - Demographic Forecasts

Year	Population ('000)	Households ('000)	Average Household Size (Persons)	Average Household Size (% change)
2001	19,413	7,367	2.64	
2006	20,555	7,968	2.58	-2.10%
2011	21,699	8,558	2.54	-1.71%
2016	22,808	9,147	2.49	-1.65%
2021	23,871	9,713	2.46	-1.44%
2026	24,873	10,217	2.43	-0.95%

Source: ABS

Australia's population growth has remained relatively stable for many decades now. Natural population growth peaked in the early 1960s and again in the 1970s. This was followed by a period of constant growth up to the present. Net migration has been volatile, as illustrated in Chart 1, and has significantly outweighed natural increase since 2005 to be almost double that of natural increase.

Chart 1 – Sources of Population Growth

Source: ABS

Net overseas migration impacts on new household formation and consequently stimulates demand for housing both in the rental and owner occupier markets. Political and economic influences can cause short-term fluctuations in net overseas migration and long-term effects on the demand for housing. Net overseas migration in Australia has fluctuated between 36,000 in 1994 and the current high of 278,000, as illustrated in Table 5. Housing demand measured in 5 year increments has increased from 140,000 in the period from 1996 to a forecast demand of 169,000 in the period from 2009. International students have a positive impact on the demand for dwellings, mostly in the larger states of New South Wales and Victoria.

Table 5 – Housing demand

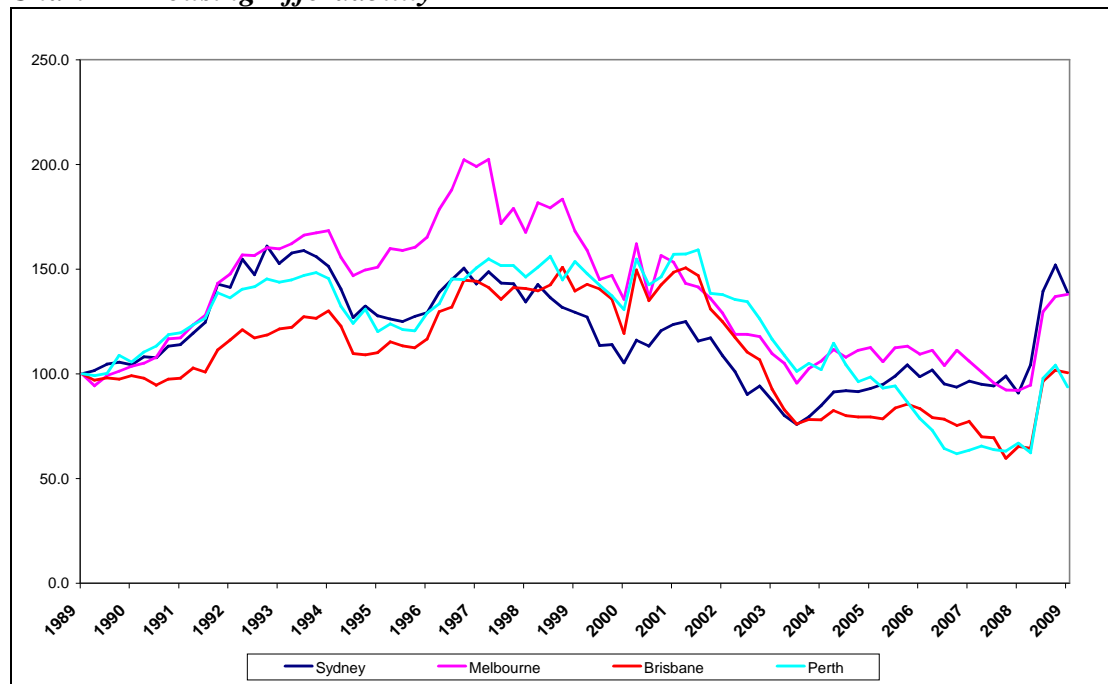
Year	Net Overseas Migration (‘000)	Housing Demand (‘000)
1986	100	
....		
1989	164	
....		
1994	36	
....		
1996	107	140
1997	102	140
1998	77	140
1999	90	140
2000	106	140
2001	129	158
2002	118	158
2003	116	158
2004	104	158
2005	118	158
2006	143	183
2007	205	183
2008	212	183
2009(f)	278	169
2010(f)		169
2011(f)		169
2012(f)		169

Source: ABS; BIS Shrapnel forecast (f)

1.1.2 Housing Affordability

Chart 2 illustrates housing affordability indices for Australia’s major capital cities. Housing affordability jumped by around 39% at the national level in the three months to 31 December 2008 following the substantial reduction in interest rates by Reserve Bank of Australia from 7.25% at the start of September 2008 to 3.0% by April 2009. As a result standard variable mortgage rates reduced from around 8.95% p.a. in September 2008 to the current level of around 5.1% p.a.

This substantial reduction in mortgage rates greatly reduced the typical mortgage repayments for variable loans making residential property more affordable. There was also a small drop in prices in most capital cities which further increased affordability.

Chart 2 – Housing Affordability

Source: Commonwealth Bank / HIA

Sydney is currently the most affordable city by a small margin over Melbourne. This reflects the relatively static or negative price movements for houses and apartments over the five year period to 30 June 2009. Perth and Brisbane have experienced strong growth over this period and are currently the least affordable cities.

Affordability declined in the June 2009 quarter in each city and regional area except for Melbourne due to house price increases, but remains well above affordability levels at 30 June 2008.

On standard housing affordability measures Australian houses have been relatively expensive. After adjusting for the high levels of migration the house price gap is in approximate equilibrium.

1.1.3 Social Trends

The increased median marriage ages, higher divorce rates along with the greater number of single households have boosted household formation and demand for residential real estate in Australia.

1.1.4 Regulatory Constraints

Constraints on urban sprawl and development restrictions in Australia's major capital cities have contributed to increased demand for residential real estate. Urban sprawl creates the need for additional hospitals, schools, public transport and other public amenities, that are costly to provide, whilst potentially imposing a high environmental burden. As a result, in 2001, 85% of the Australian population lived within 50

kilometres of the coastline³ whilst urban areas cover less than 0.3% of Australia's land mass⁴.

Development restrictions and urban consolidation collectively prevent land being used most efficiently. Landowner preferences for land usage are constrained by planning authorities which create artificial scarcity that drives up the value of land. Insufficient supply is a key driver of house price escalation and government regulatory policies are a key factor in rationing land availability.

1.1.5 Government Initiatives and Tax Concessions

There have been a number of Government initiatives introduced by Federal and State Governments designed to assist residential property owners. Of note is the First Home Owners Grant (FHOG) which was introduced to offset the effect of the GST on home ownership by providing a grant to first homeowners. This grant has contributed in part to the demand for houses. As a part of Budget 2009-10 the Australian Government announced a First Home Owners Boost (FHOB) which consisted of a further \$14,000 for existing homes and \$21,000 for new homes in addition to the existing state grants. The FHOB is due to end on 31 December 2009. The original FHOG of \$7,000 will remain available for first home buyers.

Also contributing to demand for residential property are tax concessions such as the 50% discounted capital gains tax for assets held for greater than one year and negative gearing which is discussed further in section 6.

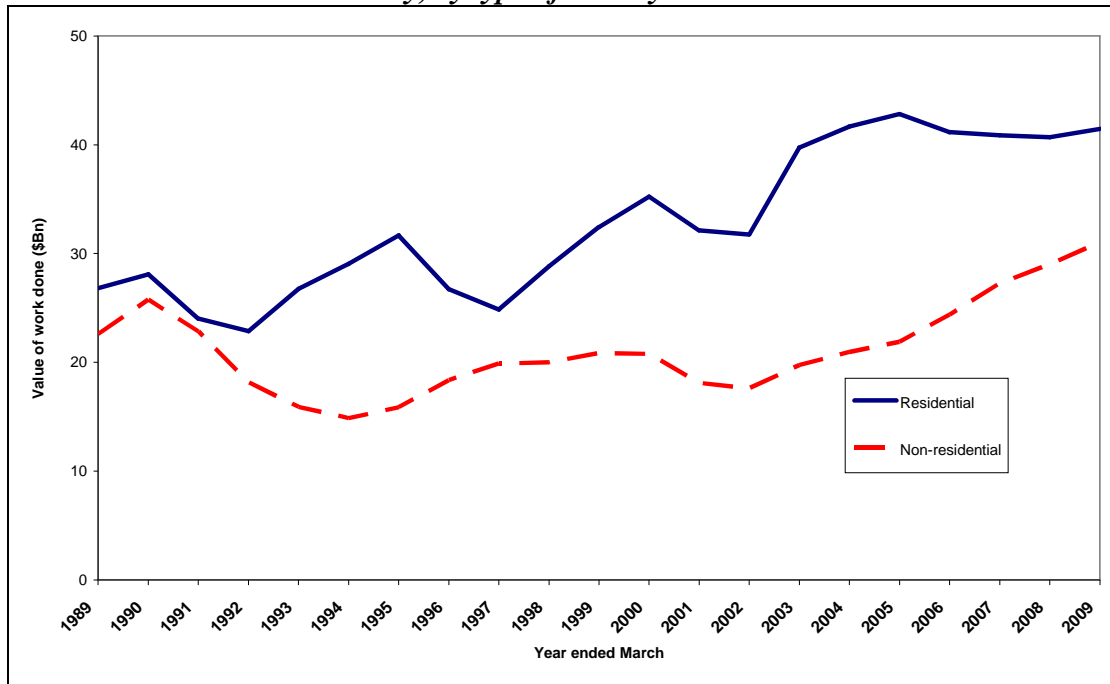
1.4 Supply drivers

1.1.6 Construction Activity

Construction activity in residential building has been steadily increasing, as shown in Chart 3, with the exception of the 2000-01 period. Over the past 20 years there has been a substantial downturn in construction following a spike generated by the introduction of the GST in July 2000. Dwelling construction has stabilised since its peak in mid-2004 until recently as the boost in the first home owners grant for new homes has resulted in a renewed surge of residential building.

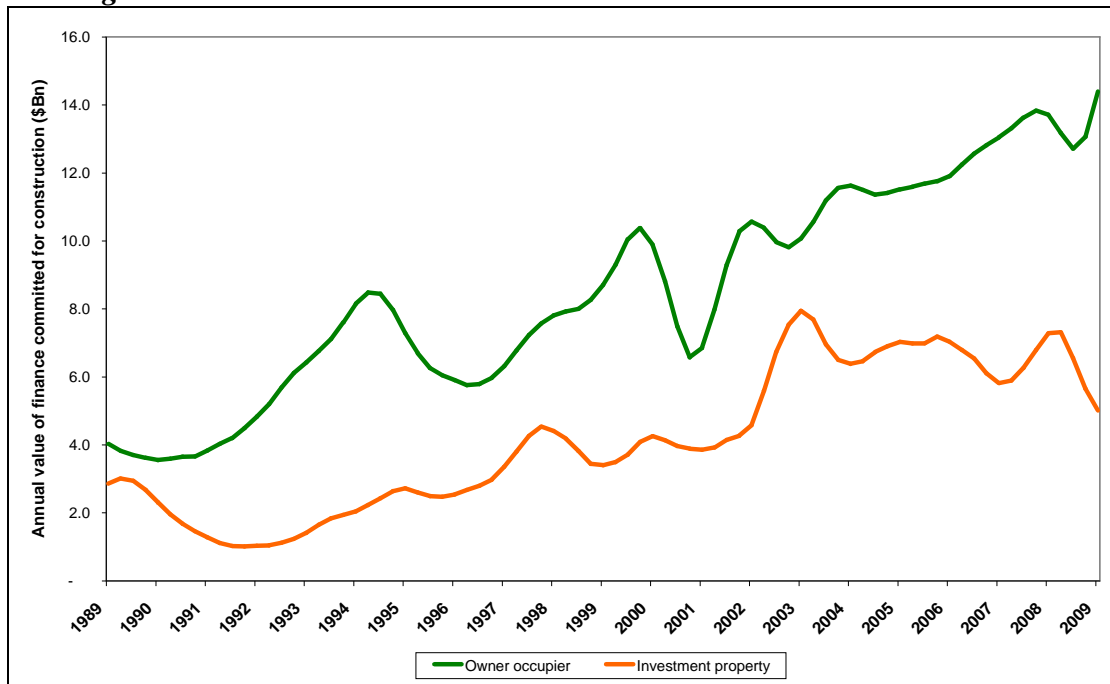
³ "Census of Population and Housing: Population Growth and Distribution, Australia, 2001" ABS

⁴ "Planning restraints; A plague on wealth and the democratic process" Institute of Public Affairs – April 2006

Chart 3 – Construction Activity, by type of activity

Source: ABS

Chart 4 shows that while the overall trend for the value of construction of houses for owner occupiers and investment properties is positive over the 20 year period to 30 June 2009, the two ownership types are generally moving in opposite directions over the shorter term as prospective owners and investors take views on affordability and rental yields.

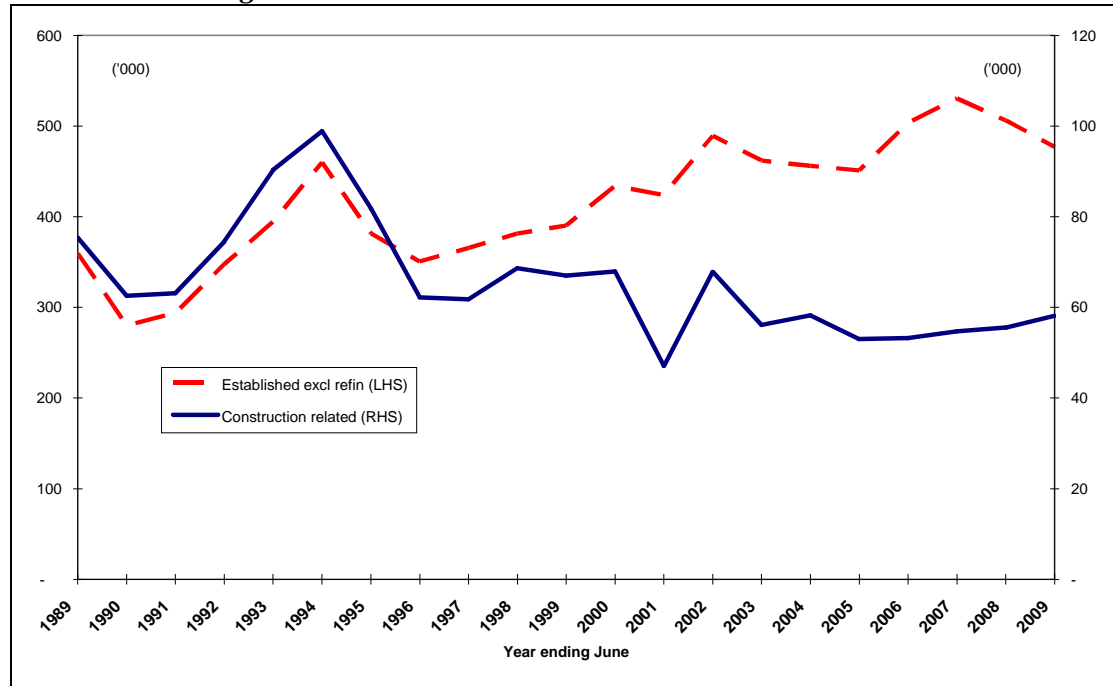
Chart 4 – Owner occupier and Investment property finance – Construction of new dwellings

Source: ABS

1.1.7 Financing Levels

Since the mid 1990s, there has been an upward trend in established housing lending which peaked in 2007 and has trended downwards over the last two years. Construction lending is lower than 2001 and is currently stable as illustrated in Chart 5.

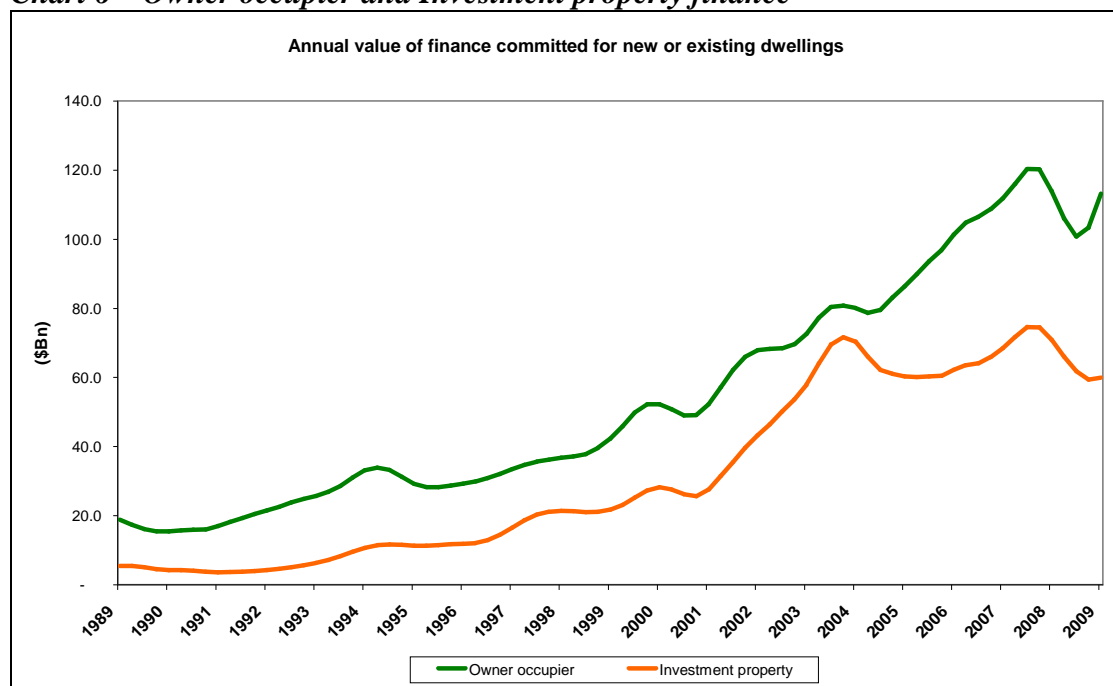
Chart 5 – Housing Finance



Source: ABS

Chart 6 shows finance for owner occupiers increasing significantly since December 2008 as first home buyers dominated the market following the boost in the First Home Owners Grant.

Chart 6 – Owner occupier and Investment property finance



Source: ABS

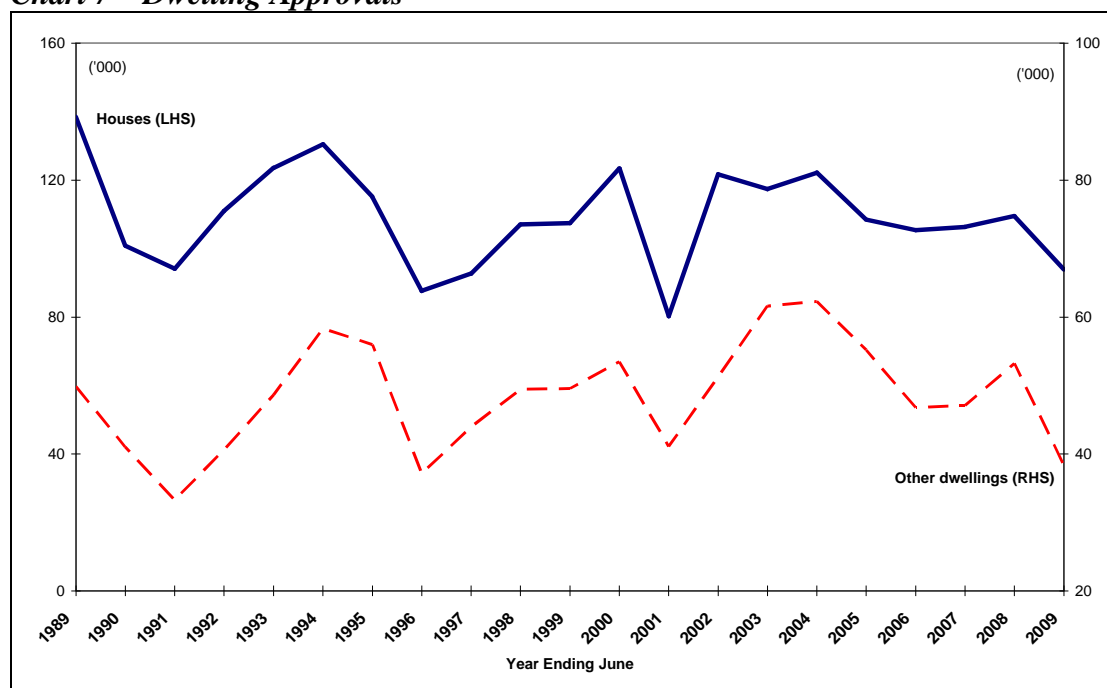
There has been a shift away from lending for investment purposes as rental yields have fallen, however this has now stabilised and is expected to increase as the Government homeowner grants are scaled down.

While the credit lending standards of Australia's banks were not as relaxed as those in the US, which had a significant proportion of low-doc 'sub-prime' mortgages, they have become more conservative since the onset of the credit crunch in mid-2007. This is evidenced by the maximum loan to value ratios (LVRs) being reduced from 95% to 90%. As a result home buyers need to save a larger deposit or look to buy a less expensive property and may restrain the growth of lower end of the housing market as the Government winds back the first home owners grant.

1.1.8 Building Approvals

Chart 7 presents the fluctuations in the number of building approvals for houses over the 20 years to June 2009. As evidenced, the number of approvals for houses and other dwellings moves in a similar trend.

Chart 7 – Dwelling Approvals

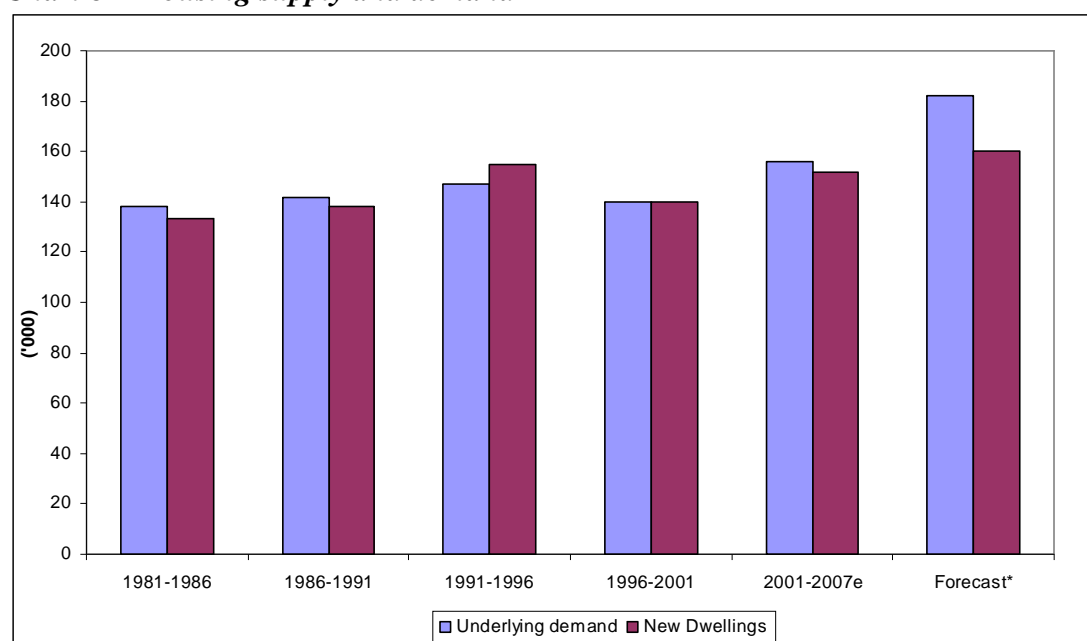


Source: ABS

There has been a significant reduction in dwelling approvals, particularly for 'other dwellings', over the year to 30 June 2009 which is in contrast to the improvement in finance for new construction.

1.1.9 Housing stock

Housing stock is growing at a slower rate than household formation as illustrated in Chart 8. This trend will support house price stability over the longer term, particularly in those capital cities where land is limited restricting the supply of new housing.

Chart 8 – Housing supply and demand

*Forecast demand 2008/09-2012/13, forecast supply for 2008-09

Source: BIS Shrapnel

Table 6 shows estimates of the annual deficiency or surplus of dwelling stock for each state and the total for Australia for the years from 2006 to 2010. Positive figures indicate a deficiency.

Table 6 – Dwelling stock deficiency – By state

	Australia (000s)	NSW (000s)	Vic (000s)	Qld (000s)	SA (000s)	WA (000s)	Tas (000s)	NT (000s)	ACT (000s)
2006	21.7	2.9	1.9	14.1	0.6	1.6	0.3	0.0	0.0
2007	47.6	18.3	7.9	17.9	1.0	1.0	0.3	0.2	1.0
2008	72.5	35.5	14.7	16.9	-0.3	3.2	0.1	1.2	1.3
2009	128.9	64.0	26.7	22.2	0.7	10.4	1.0	2.4	1.6
2010(f)	151.6	83.7	25.7	27.2	-1.8	11.2	0.9	3.3	1.5

Source: BIS Shrapnel

As shown in Table 6 the deficiency in dwelling stock more than doubled in 2007 and has since continued to increase at a rapid pace. Queensland was initially the main source of undersupply and this has been relatively steady since. NSW has grown from contributing almost 40% of Australia's dwelling stock undersupply to be the cause of over half of this deficiency.

1.5 Vacancy Rates and Rental Growth

1.1.10 Vacancy rates

Vacancy rates for residential rental properties provide a good indication of the degree of shortage or surplus of stock in market. BIS Shrapnel suggest that a vacancy rate of 2.5% or lower indicates a high level of demand whilst in a balanced market a vacancy rate of 3% would apply. Australian rental vacancy rates are at their lowest level since

records began almost 40 years ago, with the exception of Perth and Brisbane which have recently increased above the five year average for those states. Vacancy rates for rented dwellings in capital cities are shown in Table 7. These figures highlight the impact of the combination of rapid population growth and inadequate supply of housing.

Table 7 – Vacancy Rates for Rented Dwellings

City	June 2009 quarter	5 year average
Sydney	1.3%	1.8%
Melbourne	1.4%	1.9%
Brisbane	3.0%	2.0%
Adelaide	1.4%	1.5%
Perth	3.5%	2.2%
Canberra	2.5%	2.5%
Hobart	2.1%	2.2%
Darwin	0.8%	2.2%

Source: REIA, Atchison Consultants

After very strong rises over the last five years the Perth housing market has slowed as the global economic downturn depresses demand for resources. An oversupply is emerging in the areas around greater Perth most affected by the downturn and as a result vacancies have risen significantly.

Renters in Brisbane taking advantage of the low interest rate environment and Government grants by buying a house or unit appear to be the main cause of increased vacancies over the six months to 30 June 2009.

1.1.11 Rental growth

Increasing demand for rental accommodation and falling rate of growth of supply has resulted in growth in rents. Many in the rental market are being forced to bid for rental properties. This has resulted in trend of significant rental growth since 2005.

Over the year to 30 June 2009 median rents for three bedroom houses have increased in all capital cities, with Hobart experiencing the greatest growth at 9.7%. Median rents for two bedroom apartments also increased in all capital cities over this period, with Hobart again providing the highest annual growth at 8%.

1.6 Summary

The estimated value of Australian residential property is \$3.2 trillion of which approximately 70% is owner-occupied with the remaining 30% rented, primarily private rental. The more populous states of New South Wales, Victoria and Queensland account for the majority of Australia's housing value.

Factors that influence demand for residential property include housing affordability, social trends, regulatory constraints and demographics. Supply drivers include construction, building approvals, financing levels and existing housing stock.

Currently there are historically low vacancy rates for rented dwellings in capital cities reflecting the impact of the combination of rapid population growth and inadequate supply of new housing. Increasing demand for rental accommodation and falling rate of growth of supply has resulted in significant growth in rents since 2005.

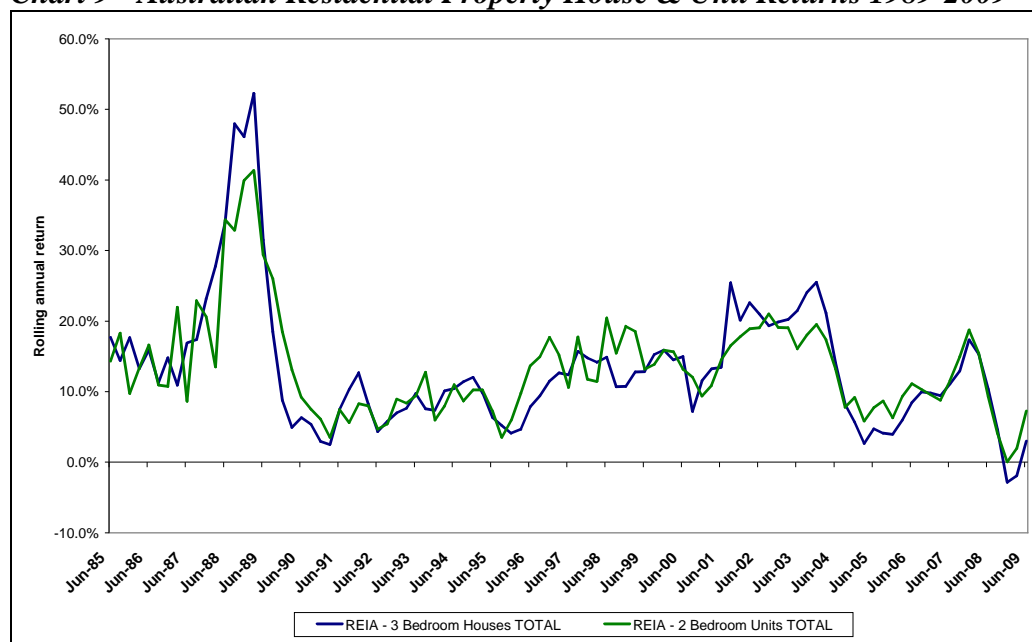
2 Investing in Residential Property

This section considers the investment potential and benefits of the residential property market against other asset classes.

2.1 Historical Long Term Performance

The long term performance of residential property has been strong, characterised by consistently positive total annual returns, with the exception of the recent performance of houses which recorded relatively minor negative returns for one year periods to 31 December 2008 and 31 March 2009. Chart 9 illustrates that the sector is relatively cyclical providing low volatility when viewed over the expected long term holding period of the assets. The spike at the end of 1980's property boom is the exception to this characteristic.

Chart 9 - Australian Residential Property House & Unit Returns 1989-2009



Source: REIA; Atchison Consultants

Table 8 illustrates the capital city level return components comprising of capital growth and income return. The strength of the apartment market is pronounced in the major capitals where land supply is constrained and density is increasing close to their respective CBDs. Overall, residential property has delivered strong returns on capital and income return basis across the major capital cities.

Table 8 - Australian Capitals Residential Property Returns 20 Years to 30 June 2009

	3 Bedroom Houses			2 Bedroom Apartments		
	Capital Growth (p.a.)	Income Return (p.a.)	Total Return (p.a.)	Capital Growth (p.a.)	Income Return (p.a.)	Total Return (p.a.)
Sydney	4.9%	3.4%	8.3%	4.8%	4.2%	9.0%
Melbourne	6.3%	4.2%	10.5%	7.2%	4.5%	11.7%
Brisbane	7.9%	4.8%	12.7%	7.5%	5.0%	12.4%
Adelaide	6.9%	4.9%	11.7%	7.0%	4.9%	11.9%
Perth	7.5%	4.4%	12.0%	8.5%	4.7%	13.1%
Canberra	7.1%	4.0%	11.1%	8.0%	5.0%	13.0%
Australia	6.5%	4.2%	10.7%	6.3%	5.1%	11.4%

Source: REIA, Atchison Consultants;

Hobart and Darwin were excluded as 20 years of data is not available

2.1.1 Residential Property Yields

While residential property does not provide the 7-8% yields offered by commercial property, table 9 illustrates the point that the Australian market is not uniform in terms of yield.

Table 9 - Yields as at 30 June 2009

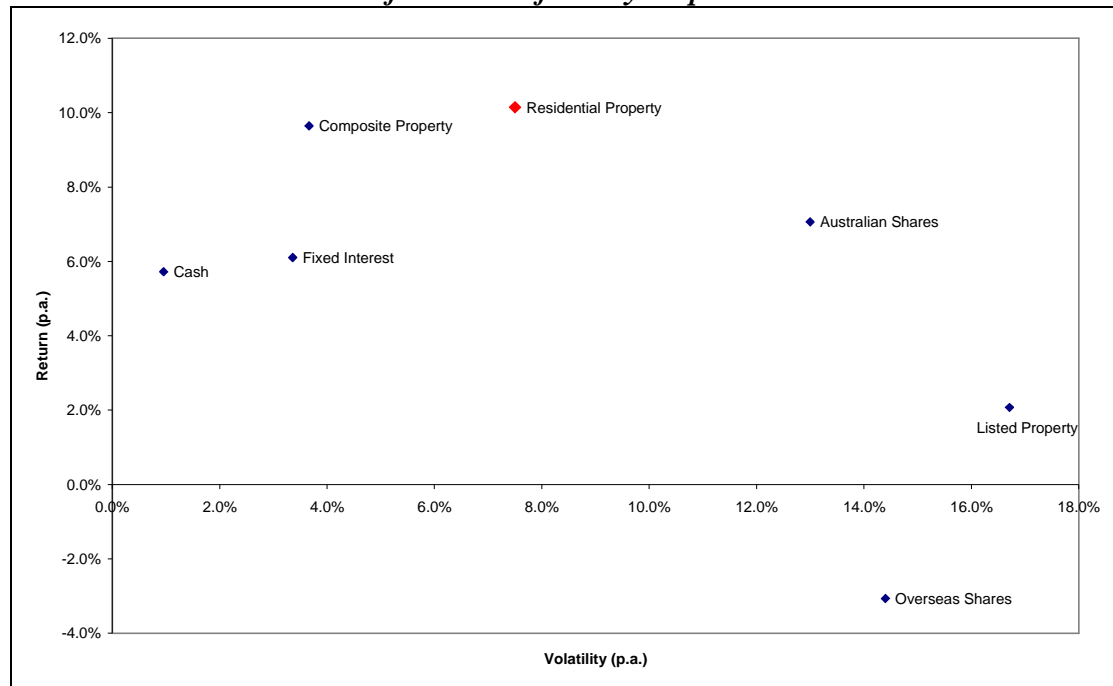
	3 bedroom houses	2 bedroom units
Sydney	2.7%	4.4%
Melbourne	2.8%	3.4%
Brisbane	3.4%	3.9%
Adelaide	3.4%	3.5%
Perth	3.3%	3.8%
Canberra	3.6%	4.2%
Hobart	3.9%	4.2%
Darwin	4.3%	4.2%
Australia*	3.0%	3.9%

* Based on population weighted average

As shown in Table 9, particular markets such as Darwin, Hobart and Canberra can provide above average yields. The total returns as shown in table 8 reinforce the notion that residential property should not be viewed as a yield investment but rather viewed as relatively low income producing assets with the potential for significant capital gains.

2.2 Residential Property versus Major Asset Classes and Property Sectors

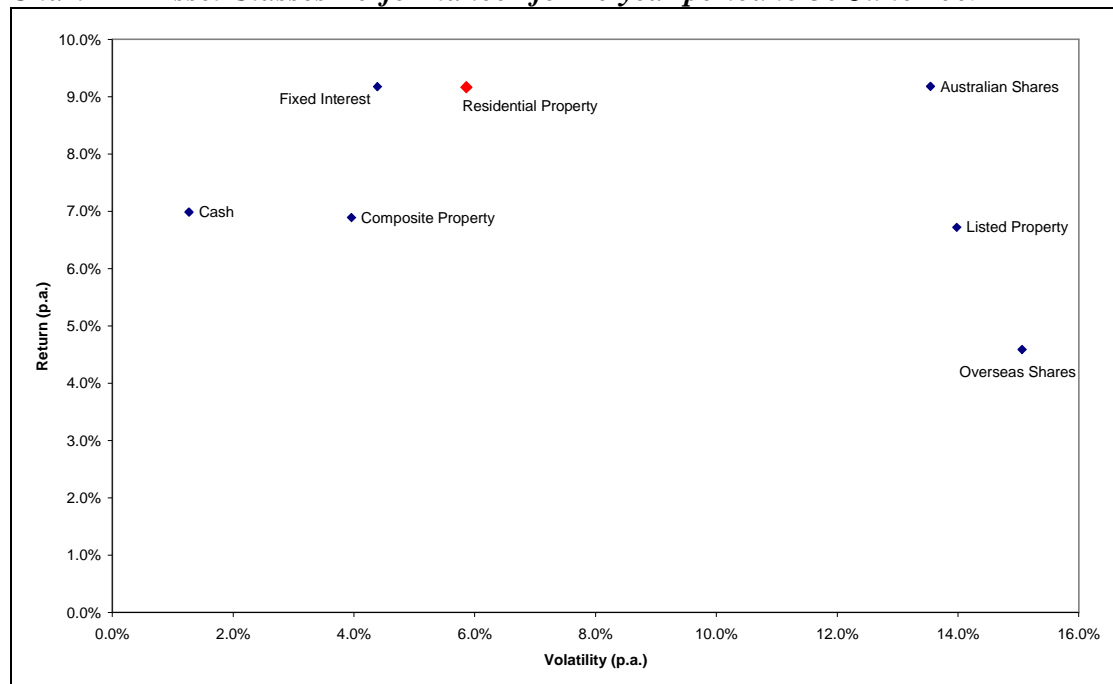
Residential property performance has been analysed on a 10 and 20 year basis against the major asset classes. The total return of residential property has exceeded all major asset classes over the 10 year period to 30 June 2009, as illustrated in Chart 10.

Chart 10 – Asset Classes Performance* for 10 year period to 30 June 2009

Source: REIA, S&P/ASX, PCA/IPD, Citigroup, UBS, MSCI, Atchison Consultants

*All investment returns are after fees returns and take into account expenses relating to acquisition, management and disposal of the asset.

Over the 20 year period to 30 June 2009, residential property has generated similar returns to Australian shares at a significantly lower volatility of returns and similar return to fixed interest at a higher volatility of returns, as illustrated in Chart 11.

Chart 11 - Asset Classes Performance* for 20 year period to 30 June 2009

Source: REIA, S&P/ASX, PCA/IPD, Citigroup, UBS, MSCI, Atchison Consultants

*All investment returns are after fees returns and take into account expenses relating to acquisition, management and disposal of the asset.

The asset classes in the performance comparison are represented by the indices in Table 10.

Table 10 - Asset Class Representative Indices

Asset Class	Source
Australian Shares	S&P ASX 200 Accumulation Index
Overseas Shares	MSCI World EX Australia Net Dividends Reinvest in AUD Standard
Australian Listed Property	S&P ASX 200 PROPERTY Accumulation Index
Direct Property	PCA/IPD Composite
Residential Property*	REIA Combined Houses and Units - Total
Australian Fixed Interest	UBS Comp. Bond Index (CBBI Hist)
Australian Cash	UBS Australian Bank Bill 0+ yrs

*REIA Total Returns for 3 Bedroom Houses and 2 Bedroom Other Dwellings were combined, according to ABS data, to form the residential property index.

2.3 Investment Horizon

The consistency of the returns of residential property is evidenced when considered across various periods to 30 June 2009 as illustrated in Table 11.

Table 11 – Residential Property Performance to 30 June 2009

Residential property	Total Return (p.a.)	Volatility of Returns (p.a.)
5 Years	8.0%	4.7%
10 Years	12.2%	5.1%
20 Years	10.9%	4.5%

Source: REIA, Atchison Consultants

The property cycle is more evident when comparing 5 year performances across the 20 year period to 31 December 2007, as illustrated in Table 12. With an appropriate investment horizon, periods of under performance can be offset with periods of strong performance.

Table 12 – 5 year Residential Property Performance

Residential property	Total Return (p.a.)	Volatility of Returns (p.a.)
5 years to 30 June 1994	7.8%	3.9%
5 years to 30 June 1999	11.3%	3.7%
5 years to 30 June 2004	16.5%	4.8%
5 years to 30 June 2009	8.0%	4.7%

Source: REIA, Atchison Consultants

2.4 Summary

Australian residential property has generated consistent strong total returns over the long term. Income returns are stable, but low compared with commercial property however residential property should not be viewed as a yield investment but rather viewed as relatively low income producing assets with the potential for significant capital gains.

When compared with other asset classes over 10 and 20 year periods to 30 June 2009 residential property has produced total returns that are either equal to or higher than the major asset classes. The volatility of total returns is significantly lower than other growth assets such as listed property and shares.

Performance of residential property is not uniform throughout Australia indicating there is potential to invest in areas that may significantly outperform others and the national average.

3 Australian Residential Property in Investment Portfolios

This section examines the benefits of integrating investment in residential property into a diversified portfolio.

3.1 Correlations with Major Asset Classes

All asset classes and the sectors that make them up differ in their investment characteristics. These might include market cycles (timing and frequency), sensitivity to economic stimulus such as interest rates and foreign exchange rate exposure.

Investing across a number of asset classes/sectors provides exposure to markets that are positive when others are negative which smoothes out the expected return. The measure for one investments relationship to another is correlation.

Correlation measures the historical movement of investments returns. Correlation of 1.00 is perfect correlation and signifies investments will rise and fall together. Negative correlation signifies one investment will rise and the other falls and a correlation of zero signifies one investment is not influenced at all by another investments rise and fall.

Residential property has low or negative correlation to all of the major asset classes, as illustrated in Table 13; the most closely related is direct property as would be expected. On this basis residential property provides a beneficial source of diversification within a diversified portfolio.

Table 13 - Asset Class Correlations - 20 years to 30 June 2009

	Australian shares	Overseas shares	Listed property	Direct property	Residential property*	Australian fixed interest	Cash
Australian shares	1.00						
Overseas shares	0.55	1.00					
Listed property	0.58	0.35	1.00				
Direct property	0.10	0.04	0.16	1.00			
Residential property*	0.16	-0.01	0.19	0.28	1.00		
Australian fixed interest	-0.14	0.10	0.05	-0.29	-0.21	1.00	
Cash	-0.08	0.12	0.10	-0.38	-0.25	0.82	1.00

Source: REIA, S&P/ASX, PCA/IPD, Citigroup, UBS, MSCI, Atchison Consultants

* REIA Combined Houses and Units (compiled by Atchison Consultants)

The correlation benefit is also present across the Australian capital cities as illustrated by combined houses and units correlation of total returns shown in Table 14.

Table 14 - Australian City Correlations – 20 years to 30 June 2009

	Sydney	Melbourne	Brisbane	Adelaide	Perth	Canberra	Hobart	Darwin
Sydney	1.00							
Melbourne	0.24	1.00						
Brisbane	0.17	0.21	1.00					
Adelaide	0.19	0.38	0.40	1.00				
Perth	0.16	-0.03	0.14	0.12	1.00			
Canberra	0.14	0.32	0.47	0.37	0.12	1.00		
Hobart	N/A*	N/A*	N/A*	N/A*	N/A*	N/A*	N/A*	
Darwin	N/A*	N/A*	N/A*	N/A*	N/A*	N/A*	N/A*	N/A*

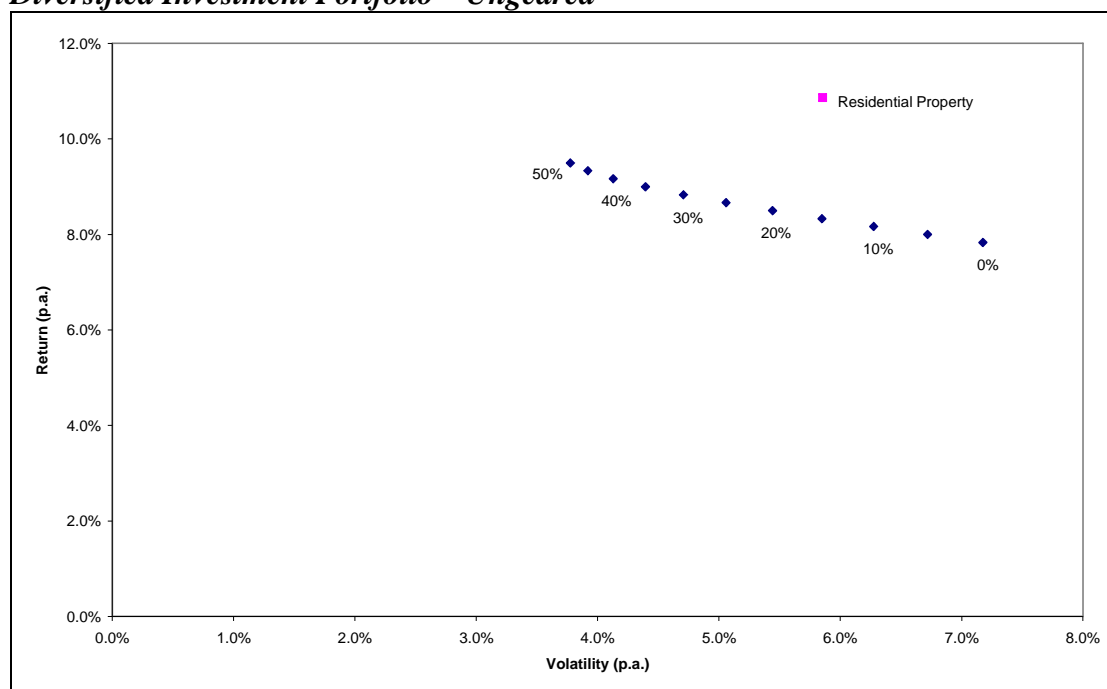
Source: REIA, Atchison Consultants

*Hobart and Darwin do not have 20 years total return history

3.2 Australian Residential Property as Part of a Portfolio

Chart 12 illustrates the impact of including residential property within the property allocation of a diversified portfolio for the institutional investor. The reduced volatility from increasing property exposure is evident across all scenarios.

Chart 12 – Volatility and Return Impacts of Residential Property included within a Diversified Investment Portfolio – Ungeared



Source: Atchison Consultants; for the 20 year period to 30 June 2009

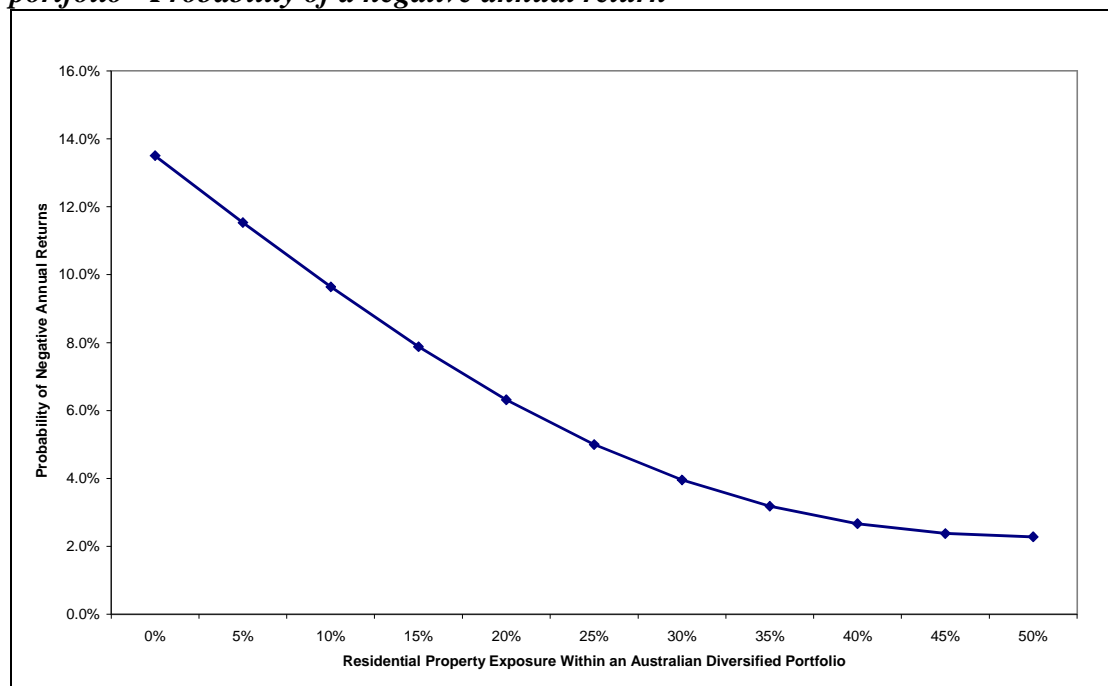
Using historical data modelled against a hypothetical portfolio. Investors should undertake their own analysis and draw their own conclusions as to what impact residential property can have on their specific investment portfolio.

When the correlation effect is combined with its relatively low volatility characteristic, the introduction of residential property into an Australian diversified portfolio provides a positive benefit.

The Australian diversified portfolio comprises 70% exposure to growth assets (i.e. shares and commercial property) and 30% exposure to income assets (i.e. fixed interest and cash).

The benefit of reduced volatility is illustrated in Chart 13 which examines the effect of adding exposure to residential property on the probability of a negative annual return.

Chart 13 – Effect of adding exposure to Residential Property in a diversified portfolio - Probability of a negative annual return



Source: Atchison Consultants; for the 20 year period to 30 June 2009

As shown in Chart 13, adding exposure to residential property of up to 20% significantly reduces the likelihood of a negative annual return. Further exposure beyond 20% also reduces the probability of a negative annual return, but to a lesser degree.

3.3 Summary

Residential property has low or negative correlation to all of the major asset classes, therefore providing a beneficial source of diversification within a diversified portfolio. Further diversification can be achieved by investing in residential property in more than one location. Adding residential property to a diversified portfolio can reduce the volatility of returns of the portfolio and thereby reduce the probability of a negative annual return.

Statement of Analyst Interest and Certification, Warning and Disclosure:

Analyst Interest and Certification:

The Analyst(s) may hold an investment in this product. Atchison Consultants does not consider such holdings to be sufficiently material to comprise the rating. The Analyst(s) certifies that with respect to content covered in this report: (1) all of the views expressed accurately reflect his or her personal views; and (2) no part of his or her compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed by that research analyst in the research report.

Warning (General Advice Only):

This report is prepared for First Charter Capital. Where the report contains recommendations and advice, it is of a general nature and does not have regard to the particular circumstances or needs of any specific person who may read it. Investors should assess either personally or with the assistance of a licensed financial adviser whether the Atchison Consultants recommendation or advice is appropriate to their situation before making an investment decision. The information contained in the report is believed to be reliable, but its completeness and accuracy is not guaranteed. Opinions expressed may change without notice. Atchison Consultants does not accept any liability, whether direct or indirect arising from the use of information contained in this report. No part of this report is to be construed as a solicitation to buy or sell any investment. Atchison Consultants does not accept any responsibility to inform you of any matter that subsequently comes to its notice, which may affect any of the information contained in this report. The performance data in this report is not a representation as to future performance or likely return.

Disclosure (Commissioned Research):

Atchison Consultants has received a fixed fee, established prior to commencement of work, plus travel expenses from First Charter Capital for the preparation of this report. Atchison Consultants applies a strict and rigorous process for the production of research reports and has no direct or indirect interest in the success or otherwise of this investment.

Atchison Consultants

Atchison Consultants was established in 2001 by Ken Atchison and consists of a team of investment professionals with extensive experience in all aspects of financial markets.

The principal focus of the business is the provision of advice and analysis across all components of managing investment portfolios by financial institutions, superannuation and insurance funds and investment managers. Primarily this involves property investments and related mortgage markets.

Atchison Consultants services and capabilities cover two distinct areas being asset consulting and investment management consulting, with a focus on the property asset class.

Licence

TAG Asset Consulting Group Pty Ltd (ABN 58 097 703 047), trading as Atchison Consultants, is the holder of Australian Financial Services Licence Number 230846.

Contact Details

Atchison Consultants

Address: Level 3, 155 Queen Street, Melbourne, Victoria 3000

Phone: 03 9642 3835

Fax: 03 9642 8886

Email: ken@atchison.com.au

Website: www.atchison.com.au