

Decoding the Departure Fee

EXECUTIVE SUMMARY

- The departure fee, which is currently the predominant financial structure applied in Australian retirement villages, can be complex and confusing for many elderly people considering a move into a retirement village. Consequently, there is much discussion in the industry at present as to whether this structure is sustainable in the long term.
- The departure fee was originally introduced to enable residents to share in the improved lifestyle offered by modern retirement villages, by way of discounting the ingoing contribution and/or service fees in return for a contribution paid out of the resale proceeds of the unit.
- Our research suggests that the original intention of the departure fee arrangement has become obscured, with the following trends noted:
 - Departure fees have become increasingly more aggressive over time.
 - Today the industry is saddled with a multitude of formulas for calculating the fee, with very little consistency between villages and states.
 - The departure fee structure in retirement villages is, in most instances, more financially onerous than alternate retiree housing options.
- As a result, there is pressure for change coming from potential residents considering entry into a village and the children of the current generation of residents.
- Jones Lang LaSalle does not forecast the demise of the departure fee in retirement villages. The resident funded model, which relies on departure fee income, will continue to appeal to a segment of the market that might not otherwise have been able to afford the security and lifestyle offered in a retirement community, if it were not able to gain access at a discounted price and/or subsidised service fees.

- However, the likely scenario moving forward is that retirement villages will increasingly lose market share to other retiree options unless the following problems are addressed:
 - The industry must communicate the purpose of the departure fee structure much more effectively.
 - Owners and operators must reconsider the aggressive nature of some departure fees and simplify the formulas used.
 - Operators and the legal profession need to revisit the wording of more complex departure fee structures and keep them clear and concise.

INTRODUCTION

The departure fee, which is presently the most common financial structure applied in Australian retirement villages, can be complex and confusing for many elderly people and is generally considered to be one of the major deterrents for residents considering a move into a retirement village.

Is there a future for this structure as the more investment-savvy baby boomers enter the market?

How can the industry achieve the best balance between the operator's return on the one hand, while improving the appeal of the departure fee to potential residents on the other?

BACKGROUND TO DEPARTURE FEES

Departure fees, also known as 'Deferred Management Fees' and 'Exit Fees', are payments made to an operator by residents in a retirement village upon vacating their units and terminating their occupancy. The payment is usually calculated with reference to the resident's length of stay. The general practice is for the owner/operator of the village to refund the resident's ingoing contribution from the proceeds of the next sale or transfer of the unit after deducting the departure fee.

Until the mid-1970s, the majority of retirement villages were owned and operated by the not-for-profit sector (mostly church and charitable organizations). Residents generally paid a non-refundable donation upon entry to the village that

guaranteed them a lifetime tenure of the dwelling, or occupancy until they decided to vacate.

However, with the cost of development increasing, particularly the added cost of providing more extensive community facilities, the industry began to look at alternative methods to fund these higher costs.

This funding structure arguably gave more residents an opportunity to share in the improved lifestyle offered by modern retirement villages.

As the majority of residents in the 1970s and 1980s had to sell their family home to fund entry into a retirement village (as do most residents today), and in many cases needed to reserve some part of the sale proceeds to help meet their daily costs of living, the departure fee method emerged. Thus, residents paid an entry price or an 'ingoing contribution' of around 70–80% of the market value of the unit or apartment upon entry to the village, and/or paid reduced service fees, effectively with the obligation to pay the balance by way of a departure fee out of the proceeds of their refund when they vacated the village.

With the entry of the for-profit sector into the industry in the late 1970s and early 1980s, the departure fee became more popular among operators as a means of funding capital works and ongoing management fees.



THE CHANGING LANDSCAPE

During the past three decades there have been numerous changes to the structure of departure fees, resulting in the industry being saddled with a multitude of formulas for calculating the fee and very little consistency between villages or states.

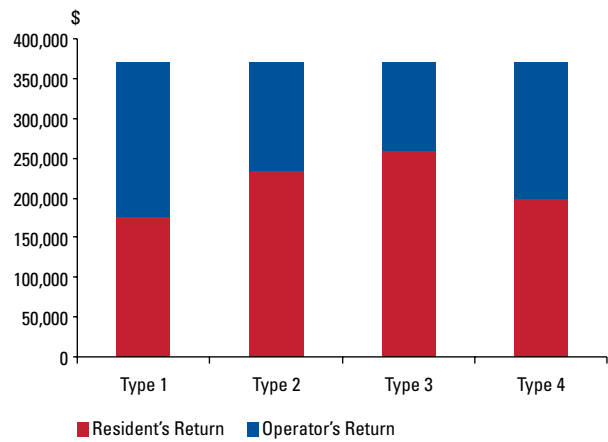
This only makes the decision by a potential resident considering entry into a retirement village more complicated, as they need to carefully consider the financial implications of the different departure fee formulas in light of the ingoing contribution they will be required to pay and their ongoing liability for service fees and possibly refurbishment costs.

We have seen the departure fee in many villages increase from 2.5% per annum to 4% per annum.

Interestingly, the changes in departure fees often mirror residential market cycles. When the residential market is strong and people can sell their homes readily, operators of retirement villages tend to become more aggressive with the departure fee. Conversely, when the residential market is weak, sales activity is slow and operators are often more willing to compromise. The result of this practice is that there can be several departure fee structures operating within one village.

Table 1 provides examples of the return to the resident and to the operator under fairly typical departure fee structures. It is assumed that in each case the resident pays a conservative ingoing

Graph 1: Relative Share of Proceeds Under Various Departure Fee Structures



Source: Jones Lang LaSalle

contribution of \$250,000 and remains in occupation for ten years before vacating the premises. Capital growth of 4% per annum has been applied.

The share of the proceeds from the resale of the unit when the resident vacates is depicted in Graph 1.

Clearly the residents benefit most where they receive some share of the capital gain (Types 2, 3 & 4). In some instances however, particularly where the operator does not share in the capital gain with the resident (Type 1), the overall refund to the resident may be less than 50% of the resale price of their unit.

Further, we have seen the departure fee in many villages increase from 2.5% per annum (common in the 1980s) to 4% per annum and even higher, increasing the financial impost on the resident. This can potentially become more onerous where residents are penalised by caps on the departure fee if they vacate early.

Table 1: Returns to the Resident and Operator Under Various Departure Fee Structures

| Departure Fee | Operator Receives | | Resident Receives | |
|--|-------------------|-------------------|-------------------|-------------------|
| | Amount (\$) | % of resale price | Amount (\$) | % of resale price |
| Type 1: 3% pa of ingoing contribution (max 30%) Resident receives no share of capital gain | 195,060 | 52.7 | 175,000 | 47.3 |
| Type 2: 3% pa of ingoing contribution (max 30%) Resident receives 50% share of the capital gain | 135,030 | 36.5 | 235,030 | 63.5 |
| Type 3: 3% pa of resale price (max 30%) | 111,020 | 30 | 259,040 | 70 |
| Type 4: 3% pa of resale price (max 30%) plus operator receives 50% of capital gain | 171,050 | 46.2 | 199,010 | 53.8 |

Source: Jones Lang LaSalle

Graph 2 highlights the diminishing share of the resale price retained by the resident as the annual departure fee percentage increases for each variation of the departure fee outlined in Table 1.

INCREASING COMPLEXITY = CONFUSION

With the introduction of new variations to the departure fee, the supporting documentation has become more detailed. It is therefore not surprising that many potential residents find the issue very confusing.

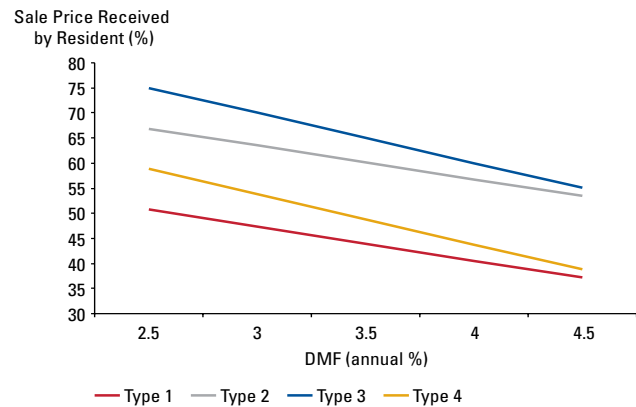
The following examples are a few of the more complex, but by no means uncommon, departure fees in use in the retirement village industry today.

In the first example, potential residents are invited to enter into a 'participating lease' or a 'non-participating lease'.

'In a participating lease, the lease holder participates in the capital gain of the unit via a reduction of the deferred management fee. The deferred management fee (DMF) will be reduced by an amount equal to 65% of the capital gain upon resale. If 65% of the capital gain exceeds the DMF, the DMF will be nil. However, the scheme operator will not be obliged to pay you the excess.'



Graph 2: Diminishing Return to Resident Under Various Departure Fee Structures



Source: Jones Lang LaSalle

In a non-participating lease, the lease holder receives a 10% discount in the purchase price of the unit, but does not benefit from any capital gain.'

The documents go on to explain that

'there is an Exit Fee which is made up of two separate fees. The DMF and the Termination Fee. The DMF is paid to the scheme operator and is calculated at 3% of the purchase of the unit for each year of occupancy over a maximum period of 15 years (this is Simple Interest NOT Compounding Interest). The Termination Fee is an administration fee to cover the termination and transfer of the lease documents and any commission due at the time of sale.'

In a second example, potential residents are advised that an exit fee may be payable to the scheme operator calculated as follows:

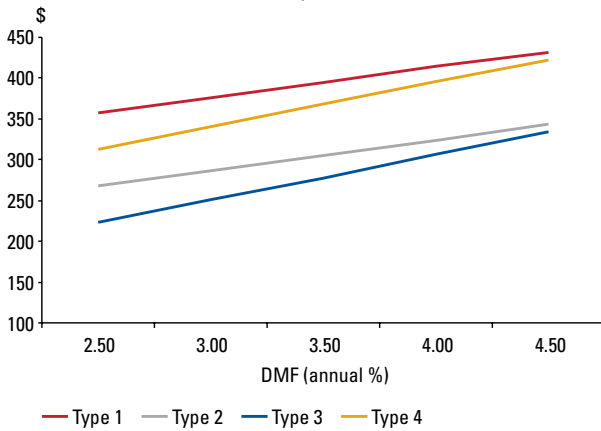
'The exit fee is an amount calculated by a formula that varies depending on whether you select a Type 1 Lease, a Type 2 Lease, a Type 3 Lease, a Type 4 Lease, a Type 5 Lease or a Type 6 Lease.'

The document goes on to give specific examples. For instance:

'If you select a Type 4 Lease your exit fee is calculated as follows:

- a) 34% of the Standard Ingoing Contribution for the first complete year of occupation plus 4% of the Standard Ingoing

Graph 3: Gross Equivalent Weekly Rent on an Ingoing Contribution of \$250,000



Source: Jones Lang LaSalle

Contribution for each additional complete year of occupation, to a maximum of ten years;

- b) If you cease to permanently occupy your accommodation unit during any additional year of your lease term, then the exit fee amount for that year is apportioned by the number of days in occupation during that year as follows:

4% of the standard ingoing contribution divided by 365 then multiplied by the number of days of occupation in that year of the lease term; and

- c) The maximum exit fee is 70% of the Standard Ingoing Contribution.'

This latter village provides a 58-page Public Information Document, of which 8 pages are dedicated to the exit fee structure and a further 5 pages provide worked examples.

WHAT IS THE 'REAL' COST TO THE RESIDENT?

If we treat the departure fee retained by the operator in Table 1 as the cost to the resident of living in a retirement village, then, in simple terms, we are able to translate these fees to a weekly 'rental equivalent' as shown in Table 2. Further, when provision is made for the cost of ongoing service fees (including rates, taxes and insurances), we are able to estimate the real cost of occupancy to the resident on a weekly basis.

Again, as the annual departure fee percentage increases and/or as the ingoing contribution increases, the real cost to the resident also increases. Graph 3 highlights the sensitivity of the gross rental equivalent to changes in the annual departure fee percentage. The ingoing contribution remains unchanged at \$250,000.

Clearly, as the departure fee increases above 3% per annum and/or the ingoing contribution exceeds \$250,000, it is understandable that the broader market may question the affordability of this option, even given the lifestyle offered.

This issue of affordability will be addressed in more detail later in this paper.

Table 2: Departure Fees Expressed as an 'Equivalent Rent'

| Departure Fee | Operator Receives (\$) | Rental Equivalent (\$) | Service Fees (\$/week) | Cost of Occupancy (\$/week) |
|--|------------------------|-------------------------|------------------------|-----------------------------|
| Type 1: 3% pa of ingoing contribution (max 30%) Resident gets no share of capital gain | 195,060 | 15,150 pa (291/week) | 85 | 376 |
| Type 2: 3% pa of ingoing contribution (max 30%) Resident gets 50% share of the capital gain | 135,030 | 10,488 pa (202/week) | 85 | 287 |
| Type 3: 3% pa of resale price (max 30%) | 111,020 | 8,623 pa (166/week) | 85 | 251 |
| Type 4: 3% pa of resale price (max 30%) plus operator gets 50% of capital gain | 171,050 | 13,285 pa (255/week) | 85 | 340 |

Note: Costs assessed over ten years. Resident remains responsible for cost of utilities and contents insurance. Capital growth of 4% pa has been applied.

Source: Jones Lang LaSalle

PRESSURE FOR CHANGE

Given the significant real cost of a departure fee for a resident in a retirement village, we believe it is a major deterrent to potential residents considering a move into a village. We also believe that there will be increasing pressure for change if the retirement village sector is to increase its rate of penetration into the seniors market, particularly where entry prices exceed median house prices in an area.

The pressure for change is likely to come from a number of groups including:

- The new residents themselves, particularly as the more financially savvy baby boomers start to consider retiree housing options;
- The children of the current generation of residents considering a move into a retirement village, whose inheritance will be diminished as a result of the departure fee; and
- New developers entering the sector who may be more willing to consider reduced departure fees to make their product more attractive to the market.

If change is not forthcoming, then what are the alternatives for residents considering a move into a seniors living community?

ALTERNATE SENIORS LIVING OPTIONS

Other than remaining at home or moving into a retirement village, the alternatives available to retirees broadly fall into three main categories:

- Over 55s Seniors Communities
- Manufactured Housing Estates for Over 50s
- Rental Villages

We stress that it is difficult to make direct comparisons between resident agreements and total occupancy costs in retirement villages versus alternate retiree housing options, when the product type, standard of accommodation, community facilities and services provided can vary significantly.

This is further complicated by the fact that the various retiree housing options appeal to different markets. For instance, manufactured housing estates tend to attract younger active retirees whereas

retirement villages and over 55 seniors communities mainly attract an older demographic. Nevertheless, the following discussion and analysis is considered to provide a reasonable indication of comparative costs.

Over 55s Seniors' Communities

From an external perspective, the larger seniors living complexes are often similar to a retirement village, providing comparable accommodation, community facilities and recreational amenities.

However, residents acquire freehold title to their units under a Strata Management Scheme and the village is controlled by the Owners' Corporation which usually engages an external Body Corporate Manager and sometimes a separate village manager.

There are no departure fees, no sharing of capital gain with the manager and refurbishment of the dwellings is at the discretion of the resident. Other than owners' corporation fees and village service fees, the only charges payable by residents are rates, taxes, utilities (telephone, electricity and gas services) and contents insurance.

The cost to the resident is the initial acquisition cost of the property (including stamp duty) and the ongoing service and strata management fees during the period of occupancy. However, upon vacating the dwelling the resident sells the property and retains the full proceeds from the sale.

Manufactured Housing Estates

Manufactured housing estates generally comprise relocatable homes within a residential setting, with community and recreational facilities set amongst landscaped surroundings.

Residents in a manufactured housing estate buy their home and lease the land upon which the home is situated. There are no additional service fees although residents are responsible for utilities such as electricity and telephone. Upon terminating their occupancy, the resident sells their home to a new resident who then enters into a new site lease agreement with the owner/operator. Pensioners may be entitled to rental assistance which further reduces the cost of the site rental.



From a resident’s perspective, the advantage of living in a manufactured housing estate is that there are no departure fees payable upon exit from the village and the resident retains the proceeds from the resale of their home less a sales commission.

The cost to the resident is the site rent which is likely to be in the order of \$100–120 per week, plus the cost of the dwelling. However, pensioners are entitled to receive rental assistance, thereby reducing their actual lease costs to about \$50–55 per week in the case of a single pensioner resident to \$65–85 per week in the case of a pensioner couple.

Rental Villages

Fundamentally, there are two levels of rental accommodation provided in villages today. Firstly, rental villages such as those operated by Village Life and the SCV Group (formerly Sunny Cove) that target the lower socio economic demographic where residents may receive some government support (known as the ‘subsidised rental model’), and secondly, those villages where the rent paid is market driven (often described as the ‘renter by choice’ model).

In the subsidised rental model, the resident pays a weekly rent, generally limited to 85% of the single aged pension and 100% of Commonwealth Government rent assistance, for which they receive accommodation, three meals per day, and bed linen and towels provided weekly. Utilities such as electricity and telephone are the responsibility of the resident. These villages generally comprise a manager’s apartment, community building and 40 to 60 fully furnished, one bedroom villa or apartment style units in landscaped surrounds.

Under the ‘renter by choice’ model the rent is market-driven rather than tied to the pension or rental assistance, with periodic market reviews. The residents also have a greater choice of accommodation, and community facilities are provided. The rent is inclusive of rates, taxes and insurances, but contents insurance and utilities such as electricity and telephone are the responsibility of the resident. Further, rents are exclusive of domestic and personal services which are an extra charge.

From a resident’s perspective the advantage of the rental model is that there are no capital costs upfront such as an ingoing contribution or the cost of purchasing a unit.

This paper focuses on the ‘renter by choice’ model as the accommodation, facilities and amenities are more comparable to typical retirement villages. We have not addressed the subsidised rental model as such villages mainly target the lower income pensioner group which is not in a financial position to fund entry into a retirement village.

In the case of the ‘renter by choice’ model, we have assumed that an operator will require a net return of 7.5–8% per annum on the value of the units. Table 3 provides a summary of the gross rents required to achieve the expected returns at different price points.

Table 3: ‘Renter by Choice’ Comparisons

| Unit Price | \$250,000 | \$300,000 | \$350,000 | \$400,000 |
|-----------------------------------|-----------|-----------|-----------|-----------|
| Net Rent (at 7.5–8% pa) (\$/week) | 361–385 | 433–462 | 505–538 | 577–615 |
| Outgoings (\$/week) | 85 | 85 | 85 | 85 |
| Gross Rent Payable (\$/week) | 446–470 | 518–547 | 590–623 | 662–700 |

Source: Jones Lang LaSalle

Table 4: Adjusted Rent

| Unit Price | \$250,000 | \$300,000 | \$350,000 | \$400,000 |
|--------------------------------|-----------|-----------|-----------|-----------|
| Gross Rent Payable (\$/week) | 446–470 | 518–547 | 590–623 | 662–700 |
| Interest (after tax) (\$/week) | 180 | 216 | 252 | 288 |
| Net Cost to Resident (\$/week) | 266–290 | 302–331 | 338–371 | 374–412 |

Source: Jones Lang LaSalle

At first glance it appears that the departure fee structure in retirement villages is the most costly of the various resident funding options available to retirees.

However, if you also consider that under the rental option the resident does not incur a cost of entry to the village, and that the after tax interest earned on this capital saving can be used to offset the cost of rent, the position is more favourable as indicated above in Table 4.

Cost Comparison

Table 5 below provides a simple cost comparison for retirees considering a move into a retirement village, rental village, manufactured housing estate or an over 55s seniors' community. In an effort to maintain a reasonable level of comparability, we have assumed

that the accommodation in all instances comprises a two-bedroom dwelling suitable for independent living with a cost/value of \$250,000. We have assumed a community centre is provided in each village.

Costs have been considered over a ten-year time frame, with service fees and rents escalated at CPI. Capital growth for dwellings within a retirement village or over 55s seniors complex has been applied at 4% per annum, and a lower rate of 0–2% per annum for manufactured houses to reflect the leasehold nature of the residents' interest.

At first glance it appears that the departure fee structure in retirement villages is the most costly of the various resident funding options available to retirees. However, the manufactured housing option is less costly only where the residents are in receipt of rental assistance from the government. For self-funded retirees not receiving rental assistance, the cost of occupation is likely to be on par with a retirement village.

Table 5: Cost Comparison Between Retirement Living Options

| Type of Housing | DMF | Rent | Service Fees | Rental Assistance | PV of Option (\$) |
|--|-----|------|--------------|-------------------|-------------------|
| Retirement Village (Types 1, 2, 3 and 4) | Yes | No | Yes | No | (124,150–173,350) |
| Rental Village (\$450–470 per week) (see note 1) | No | Yes | No | See note 2 | 8,750–19,400 |
| Manufactured Housing Estate | No | Yes | No | Yes | (101,700–131,150) |
| Over 55s Seniors Community | No | No | Yes | No | (100,200) |

Note 1: It is assumed that interest earned on capital costs saved will be used to offset the cost of rent.

Note 2: Rental assistance may be received by some pensioners paying a market rent. Our analysis ignores any government rental assistance (i.e. it assumes the worst case scenario for the resident).

Source: Jones Lang LaSalle

Further, while over 55 seniors communities appear less costly, our experience has been that fewer facilities and services are provided at the same price point as entry to a retirement village, and this is not reflected in the above analysis.

The rental model provides the least expensive option for residents as they incur no upfront entry price, the savings of \$250,000 is preserved, and the after tax interest earned on savings of \$250,000 can be used to offset the cost of rent.

Retirement villages will increasingly lose market share to other retiree options unless the problems attributed to a departure fee structure are addressed.

Graph 4 compares the gross rental equivalent of a number of departure fee structures at varying price points with the market rental option.

Finally, we stress that this analysis does not consider the cost of refurbishment for residents in retirement villages, manufactured housing estates and over 55s seniors communities. This only increases the cost of those options compared to the rental model where the owner/operator is responsible for refurbishment.

However, the immeasurable factor in comparing affordability in various seniors housing options compared to living at home is the value to a resident of community facilities and amenities, companionship, security and availability of care services offered in various seniors living communities that may not be readily available if living at home. These are the important decision drivers that entice people into seniors living communities and which make any comparison against the cost of living at home extremely difficult.

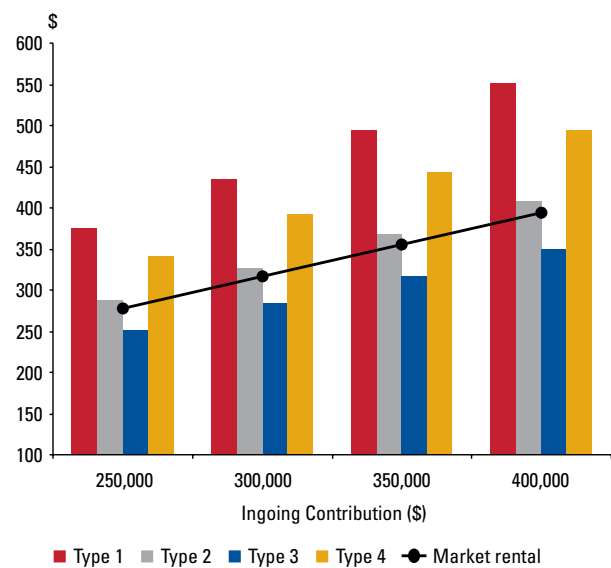
CONCLUSIONS

Despite the apparent shortcomings of the departure fee structure common in retirement villages, we are not forecasting the demise of the departure fee. In fact, we believe that the resident funded model that relies on departure fee income will continue to appeal to a segment of the market that might not otherwise have been able to afford the security and lifestyle offered in a retirement community if it were unable to gain access at a discounted price and/or benefit from subsidised operational charges.

The more likely scenario is that retirement villages will increasingly lose market share to other retiree options, unless the problems attributed to a departure fee structure are addressed. In particular:

- The industry needs to communicate the purpose of the departure fee far more effectively.
- Owners and operators must reconsider the aggressive nature of some departure fees and simplify the formulas used.
- Operators and the legal profession need to revisit the wording of more complex departure fee structures and keep them clear and concise.

Graph 4: Departure Fees as a Rental Equivalent vs Market Rents



Source: Jones Lang LaSalle

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ABOUT JONES LANG LASALLE

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