RESEARCH INSIGHT

Knight Frank

NOVEMBER 2013

RETAIL INVESTMENT

NATIONAL BRIEF

2013 Year to Date Transaction Activity

Overview

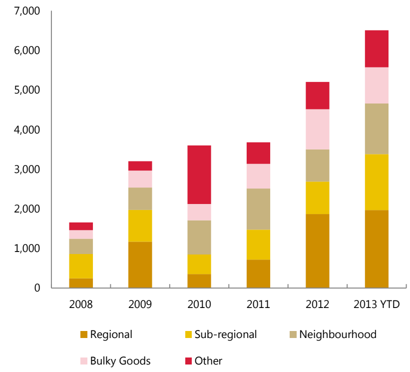
The upward trend in transaction volumes in the retail sector since 2009 has continued in 2013 with strong demand from both local and offshore investors. The year to date national retail asset sales currently amount to $6.51 billion, already a 25% increase above the 2012 figure (excluding the 2012 Westfield AMP restructure/transactions). The strong investment market appetite has grown in 2013 despite retail conditions remaining relatively soft with below average turnover and high household savings rates. Nevertheless, good quality shopping centres and freestanding supermarkets with a high level of secure income have been keenly sought.

With the majority of AREITs and large Institutional investors actively managing portfolio compositions, offshore buyers have emerged as the largest net acquisition group with net purchases of $1.902 billion so far in 2013 (accounting for 32.8% of total sales). The bulk of this activity has largely stemmed from Regional Centre acquisitions. AREITs and Unlisted funds have been net sellers of Regional and Sub-Regional assets, however net buyers of Neighbourhood Centres.

Figure 1

National Retail Transactions

By Centre Type ($mil)



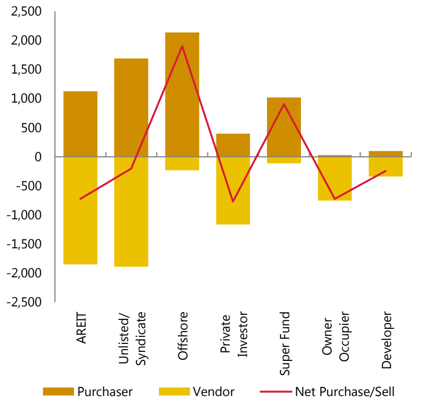
Source: Knight Frank

Depending on location and competition within a Centre's catchment area, there remains pressure on specialty rental growth. However, landlords have become more pro-active and innovative in responding to the challenges posed by soft consumer spending and the competition from online trade. Shopping Centre owners have increased capital expenditure overall as traditional retailing aims to focus on the experience aspect for customers. Figures from IPD indicate average annual capex for retail was $84/m² in the year to September, a 29% increase on the three year average of $65/m². This is close to twice the growth for all property types. Although online sales continue to outpace traditional bricks and mortar in turnover, there has been a notable decline in the rate of growth over 2013. According to the NAB Online Sales Index, September online sales showed annual growth of 10.7%, a deceleration from the 20% plus growth rates achieved in 2011 and 2012.

Figure 2

Retail Purchaser/Vendor

Sales ($m) over $10 million 2013 YTD



Source: Knight Frank

Table 1

Recent Major Portfolio Sales

Vendor	Purchaser	Sale %	Price ($mil)	Average Initial Yield (%)	Details	Sale Date
SCA Property Group	Lascorp	100%	53.6	U/D	1 Neighbourhood and 4 Freestanding	Nov-13
Private Consortium	SCA Property Group	100%	145.7	8.10‡	1 Sub-Regional and 6 Neighbourhood	Nov-13
Bunnings Group Ltd	BWP Trust	100%	271.3^	7.19‡	10 Bunnings Properties	Jul-13
Federation Centres*	Challenger/ADIC	50%	~602.0	7.42	2 Regional; 3 Sub-Regional; and 1 Neighbourhood Centre	Jun-13
Lascorp	SCA Property Goup	100%	135.8#	7.80	5 Neighbourhood and 2 Other	Jun-13
Wesfarmers (Coles)	ISPT Retail Australia Property Trust	75%	~400.0	U/D	1 Sub-Regional and 18 Neighbourhood Centres	May-13
Federation Centres	ISPT Core Fund	50%	371.4	7.49	4 Sub-Regional and 1 Neighbourhood	Feb-13

Source: Knight Frank * and associated syndicates # includes $2 million development land ‡ reported weighted cap rate
^ for development properties, the total price is an on completion basis. Total excludes acquisition costs of approximately $12.4 million

Although there has been minimal movement in average core market yields over the course of 2013, a degree of tightening has been evident in some recent sales of prime grade assets with stabilised income. This has mostly been evident in the Neighbourhood category and also Sub-Regional in WA. However there remains a large disparity with secondary stock where location or lease covenant may be less favourable. Yields on some of these assets remain relatively soft and some cases have shown some further modest softening in 2013. Evidence has started to emerge of higher levels of competition for secondary assets further up the risk curve, notable amongst Syndicates. However there remains sufficient portfolio rebalancing amongst major groups to suggest that material pick up in secondary activity will become more of a factor in 2014.

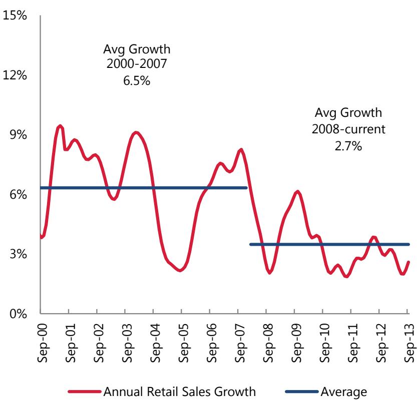
Retail Sales

In a positive sign that lower interest rates and the rise in sentiment levels are starting to gain some traction with consumers, retail sales activity has shown signs of improvement since the middle of the year. National annual retail sales growth to September measured 2.9%, and although still below long run levels, growth has accelerated each month since June. Growth across the states is broadly in line with the national average, excluding some softening in WA sales growth (albeit still positive).

Figure 3

Retail Turnover - Australia

Annual growth since 2000 (%)



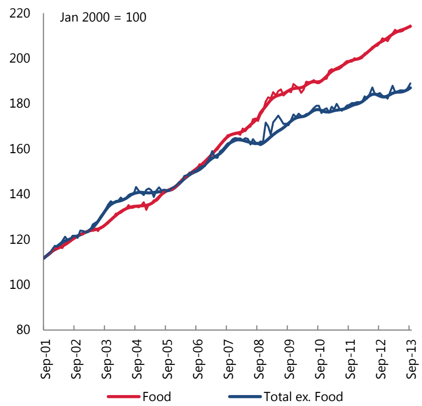
Source: ABS/Knight Frank

Food retailing, which has now outperformed more discretionary categories for the best part of five years, continues to grow at a relatively stronger rate. The last five years has seen food retail post annual average growth of 4.6% compared to 2.5% for non-food categories. This trend has been consistent with results reported by major retail landlords. With labour market conditions still relatively patchy, the divergence in retail categories is likely to persist into 2014, although not to the extent of recent years given low interest rates and rising household net wealth.

Figure 4

Retail Turnover by Category - Australia

Food vs Non-Food



Source: ABS/Knight Frank

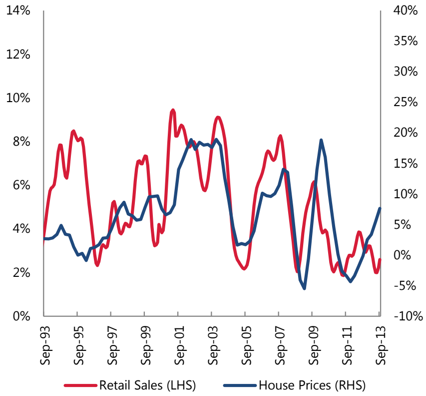
It is anticipated that retail expenditure will continue to show modest improvement into 2014. Annual house price growth as measured to September is now tracking in excess of 7%, which is likely to exert a positive wealth impact on household expenditure. As per Figure 5, there is a close relationship between house prices (as a proxy for wealth) and retail spending, which suggests a degree of upside in 2014. There appears capacity for such a rise. The household savings ratio has averaged 10.1% in the five years since mid-2008, while major banks report that almost two thirds of mortgage borrowers are ahead on repayments.

Nevertheless, it is noted that a number of factors will continue to temper the rate of improvement. Trend employment growth has slowed to sub 1%, with full-time growth having turned negative. This has been accompanied by a slowing in annual wage growth to 2.7% as at September, which is the slowest rate of growth since mid-2010.

Figure 5

Retail Turnover vs House Prices

Annual growth – Australia (%)



Source: ABS/Knight Frank

Regional Centres

The strong interest from investors for core assets has underpinned strong buying activity for Regional Centres. The year to date sales amount to $1.97 billion, which has eclipsed the $1.87 billion recorded in 2012 (excluding the transactions from the restructure of ownership interests between AMP and Westfield in 2012). This is a stark contrast to the years immediately following the GFC, where sales volumes averaged $620 million between 2008 and 2011.

The majority of Regional Centre owners report that vacancies remain relatively low. However soft retailing conditions, in addition to online shopping behaviour, has continued to constrain rental growth. Additionally, Regional Centre occupancy costs for specialty stores averaging close to 20% continue to place pressure on tenants and limit the capacity for potential rental growth in the near term. This has also been a factor behind major groups reporting instances of negative re-leasing spreads, particularly for incoming tenants.

Strong demand from offshore investors for larger sized acquisitions has seen the bulk of offshore capital by value invested into Regional Centres. 2013 sales include Blackstone acquiring Greensborough Plaza in Victoria for $360 million and National Pension Service (NPS) of South Korea acquiring GPT's 50% share in Erina Fair in NSW for $397.1 million. Challenger also acquired a $602 million portfolio on behalf of Abu Dhabi Investment Corporation (ADIC), Knight Frank

which included Centro Roselands and Centro Bankstown (both NSW) in addition to three Sub-Regionals and a Neighbourhood Centres. By value, 63% of year to date retail assets sold to offshore purchasers have been Regional Centres.

Other major sales included UniSuper buying Westfield's 33% share in the Karrinyup Shopping Centre, Perth for $246.7 million in September (taking their ownership share to 100%), while QIC made two acquisitions earlier in the year (Claremont Quarter, WA and Logan Hyperdome Qld).

Sub-Regional Centres

Sub-Regional sales volumes to date in 2013 amount to $1.41 billion, which is 73% above the $817.7 million recorded in 2012. While almost all buyer groups have made acquisitions, only Offshore, Privates and Super Funds have been net buyers. AREITs and Unlisted/Wholesale funds, although making select purchases, have on balance been net sellers.

Tenancy mix remains a key differentiator between assets with strong buyer depth for centres with relatively higher weightings of food and services tenants. Such tenants have mostly been less impacted by consumer trends and factors such as online competition. Relatively lower occupancy costs in Sub-Regional assets (and likewise with Neighbourhood) have been another attraction for investors. Major landlords report occupancy costs of circa 12% to 13% for Sub-Regional centres, well below Regional costs. Should the $AUD move materially lower in 2014, specialty stores would be better placed to absorb any margin pressure from increased inventory costs, notwithstanding a likely lessening from offshore competition.

The total value of asset sales have been significantly boosted by a number of portfolio transactions, which have accounted for 38% of Sub-Regional sales in 2013, equivalent to an apportioned amount of $537 million. However the bulk of these occurred in the first half of the year, with an increase in direct single asset sales in the second half of the year. These sales have been driven by a broad mix of buyer types. Listed trust, Charter Hall, acquired Southgate Plaza Shopping Centre (SA) for $60 million and Rosebud Plaza (Vic) for $100 million, while unlisted groups including Challenger Life Company and Engage Capital have both made acquisitions, namely Bunbury Forum (WA, $143.275 million) and Deception Bay (Qld, $37.5 million) respectively. LaSalle Investment Management has reportedly acquired Bonnyrigg Plaza (NSW) for approximately $80 million from a South Australian Private, with the Centre approved for a significant extension.

Neighbourhood Centres

The food based nature of Neighbourhood Centres has seen a sustained period of strong investor demand for this category. The year to date sales amount to $1.28 billion, which has already exceeded the average annual volume of $905.6 million recorded in the preceding three years. After accounting for 26% of total retail asset sales during 2010 and 2011 when Neighbourhood sales volumes exceeded all other categories, the proportion of total sales has now settled at 19% as activity in other categories has started to 'catch up'.

Major landlords report that amongst store categories, retail sales growth has been strongest for Supermarkets. This has benefitted Neighbourhood assets to the extent that rents have either held steady or posted some minor growth over the past year. As a result, the 9.6% total return from the Neighbourhood category in the year to September 2013 was the highest amongst all retail categories (IPD).

The majority of buyer groups have actively traded assets in 2013, however AREITs, unlisted and wholesale funds, super funds and offshore investors have all increased their exposure to Neighbourhood Centres. The largest transaction involved the ISPT Retail Australia Property Trust entering into a JV with Coles by acquiring a 75% share in

Table 2

Regional/Sub-Regional Retail Transactions - Select recent transactions

Centre	Price	Core Mkt Yield (%)	GLAR	$/m²	Vendor	Purchaser	Sale Date
Regional							
Karrinyup Shopping Centre, Perth (33.3% share)	246.7	5.70	53,282	14,031#	Westfield	UniSuper	Nov-13
Erina Fair, NSW (50% share)	397.1	6.00	101,800	7,802	GPT Group	NPS (Korea)	May-13
Greensborough Plaza, Vic	360.0	7.00	61,743	5,831	Lend Lease (APPF)	Blackstone	Jun-13
Logan Hyperdome, Qld (50% share)	340.0	6.25-6.50	82,500	8,242	John Longhurst	QIC	Feb-13
Sub-Regional							
Rosebud Plaza, Vic	100.0	7.80»	24,582	4,068	Colonial (CFS)	Charter Hall (CQR)	Nov-13
Bunbury Forum, WA	143.28*	6.70	22,367	6,406	Atlas Point	Challenger Life	Sep-13
Southgate Plaza Shopping Centre, Morphett Vale , SA	60.00	7.50‡	15,844	3,787	ISPT	Charter Hall (CQR)	Oct-13
Deception Bay, Qld	37.50	8.75^	15,300	2,451	Raptis Group	Engage Capital	Aug-13
Centro Gympie, Qld	63.80	7.75	14,046	4,539	Centro (MCS9)	Federation Centres	May-13

Source: Knight Frank * includes additional non-contiguous land # high rate reflects premium for 100% ownership ^ includes surplus land of 1 Ha
‡ fully leased yield » reported initial yield

Knight Frank

19 Coles-owned shopping centres for around $400 million. The JV is looking to grow the portfolio with the Brighton Village acquisition in Butler WA in November from Primewest already adding to the JV. Other major portfolio acquisitions have included SCA acquiring seven assets (located in Victoria and Queensland) from Lascorp for $135.8 million and Australian Property Opportunities Fund acquiring two Coles assets in Port Macquarie, NSW and Lynbrook Victoria for a combined $47.35 million.

Slightly more than half, or 51%, of acquisitions by Private Investors in 2013 have constituted Neighbourhood assets. The majority of these sales have been for assets between $20 million and $30 million. There remains a number of buy mandates from privates in the sub-$30 million range, which will continue to underpin demand in 2014.

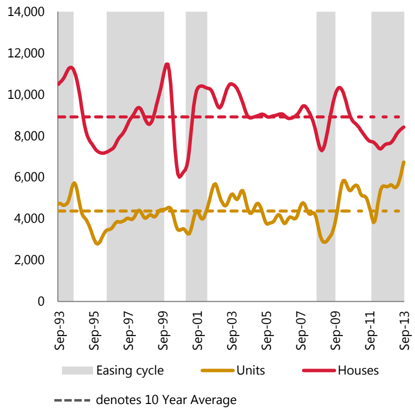
Bulky Goods Centres

Expenditure growth on household goods has been one of the softer performing retail categories over the past two years, growing a soft 1.1% per annum during this 2-year time period. However, the cyclical pickup in residential construction appears to be flowing through to household goods retail sales with trend annual growth rising to 2.1% as at September. Further improvement is expected given the September building approvals data was the highest result since early 2010. Growth has been most pronounced in NSW, where trend approvals are the highest level since 2002. Although these factors present a positive framework at a broad level, the housing market remains uneven across the country with higher density areas benefitting from the relatively stronger improvement in apartment activity. As a result, individual asset performance remains inconsistent and is resulting in a relatively wide yield range for which assets are trading on.

Figure 6

Dwelling Approvals - Australia

Monthly by Number



Source: ABS, Knight Frank

YTD 2013 sales of Bulky Goods Centres amounts to $915.62 million. Driving this

Table 3

Neighbourhood/Bulky Goods Retail Transactions - Select recent transactions

Centre	Price	Core Mkt Yield (%)	GLAR	$/m²	Vendor	Purchaser	Sale Date
Neighbourhood							
Lake Innes Village, NSW	17.35	8.60‡	3,384	5,127	Coles	Australian Property Opportunities Fund	Oct-13
Ashmore City Shopping Centre, Qld	37.00	8.50*	8,800	4,205	Private	Engage Capital	Oct-13#
Menai Marketplace, NSW	31.50	9.83	10,796	2,918	Charter Hall (DRF)	Sentinel Property Group	Sep-13
Fairview Green Shopping Centre, SA	24.75	8.50*	6,645	3,725	Private	Primewest	Aug-13
Inala Plaza Shopping Centre, Qld	32.35	11.50*	16,551	1,955	360 Capital Retail Fund	Raptis Investments	Jul-13
Woodcroft Centre, NSW	22.60	8.90*	4,667	4,843	Federation Centres^	Haben Funds Mgmt	Jul-13
Great Western Super Centre, Qld	62.9	7.75	15,386	4,088	Brookfield Multiplex	Charter Hall Retail/Telstra JV	Jun-13
University Hill Shopping Centre, Vic	33.14	8.13	7,647	4,333	MAB Corporation	Private Investor	Jun-13
Healesville Walk Shopping Centre, Vic	22.10	7.82	4,971	4,243	Australand and BOSI	Private Investor	Jun-13
Bulky Goods							
Home HQ, Artarmon, NSW	72.50	9.50	22,440	3,231	Charter Hall Opportunity Fund No.4	Blackstone	Sep-13
The Zone Oxley, Qld	17.10	9.50	8,228	2,127	Receivers & Managers	Private Investor	Aug-13
Belrose Supa Centa, NSW	88.00	8.26	32,053	2,777	Terrace Tower Group	BBRC Belrose Fund	Aug-13
Logan Mega Centre, Qld	52.00	9.50	26,995	1,926	Mirvac	Blackstone	Jul-13
Fortitude Valley Homemaker City, Qld	103.20	9.00	38,298	2,695	GPT	Altis Property Partners	Jul-13
Auburn Homemaker Megamall, NSW	55.00	Conf.	32,347	1,700	AMP Capital & Unisuper	Primewest	Jul-13
Castle Hill Homemaker Centre, NSW	19.00	10.98	11,602	1,638	Aspen Diversified Property Fund	Private Investor	Feb-13

Source: Knight Frank ^Retail Direct Property Syndicate 34 * Reported passing yield # delayed settlement ‡ fully leased yield figure was a 10 asset portfolio sold by Bunnings to the Bunnings Warehouse Property Trust for $271 million in August. At the same time the Trust also announced the acquisition of the Bunnings Hoxton Park Central for $40.75 million. After emerging as a net buyer in 2012, unlisted wholesale funds have continued to be active in 2013 acquiring $327.9 million of assets so far this year (compared with $497.8 million in 2012). While a number of asset sales have been sub $25 million, groups such as Prime West, Altis Property Partners, Blackstone and BB Retail Capital have acquired larger assets in excess of $50 million.

Investment Yields

Although average core market yields for retail assets have generally held relatively steady over the last three years, there remains a large differentiation between values for prime and secondary assets. Increased buyer demand that has selectively been directed towards good quality retail centres or stand alone supermarkets has seen a degree of firming for lower risk assets. However, secondary assets impacted by inconsistent trading conditions remain heavily discounted by the market. This has resulted in relatively large ranges for average core market yields, as detailed in Table 5.

Table 4
Retail Core Market Yields
By Centre Type (%)

Centre Type	Typical Core Market Yield (%)
Regional	5.25 - 6.50
Sub-regional	6.50 - 9.00
Neighbourhood	7.25 – 9.00
Bulky Goods	8.00 - 11.00

Source: Knight Frank

Outlook

Although the drivers for retail spending remain mixed, the impact of lower interest rates and rising wealth levels provide scope for an element of improvement in 2014. However as households continue to show a growing propensity to spend on services such as travel and health, the non-discretionary categories within bricks and mortar retailing such as food are expected to continue outperforming. The growth in online retailing remains a competitive force on retailers, however landlords appear to be actively managing tenancy mixes and focusing on the experience aspect of a centre to the benefit of income sustainability. Although the $AUD has continued to trade above the majority of estimates of fair value, traditional bricks and mortar turnover stands to benefit from any currency depreciation that would soften online completion.

Rental growth is not expected to show material improvement in the near term with specialty rents expected to remain under pressure. Lease expiry/renewal risk will remain an important factor for owners to manage with the potential for some further negative reversion at renewal. Value appreciation will therefore be dependent on the yield side of the equation.

While so far in the cycle, the increase in transaction volumes have provided scope for investors to actively manage portfolio compositions, the next stage in the cycle is expected to see groups looking to increase the size of retail exposure. Offshore groups are already endeavouring to do this. However historically low borrowing costs and, in the case of listed groups, average equity prices trading at a premium to NTA, are likely to see local investors looking to also become net buyers. This will see the firming bias for prime assets remain in place over 2014. In the short term, secondary assets are expected to continue trading at a larger than average discount to prime at this point in the cycle. While the sales activity in categories such as Bulky Goods and some recent asset sales with development potential provide evidence of investors looking further up the risk curve, any material firming bias in secondary is not expected until 2014.

KnightFrank.com.au

Knight Frank Research

Nick Hoskins
Associate Director
Research NSW
+61 2 9036 6766
Nick.Hoskins@au.knightfrank.com

Matt Whitby
National Director ,
Head of Research & Consulting
+61 2 9036 6616
Matt.Whitby@au.knightfrank.com

Agency Contacts

Ben Stewart
Director
Retail Investment Sales
+61 2 9036 6625
Ben.Stewart@au.knightfrank.com

Knight Frank Valuations

Matthew Russell
National Director
+61 2 9036 6619
Matthew.Russell@au.knightfrank.com

Phil Allenby
Associate Director, NSW
+61 2 9036 6775
Phil. Allenby@au.knightfrank.com

Michael Schuh
Director, Valuations Vic
+61 3 9604 4726
mschuh@vic.knightfrankval.com.au

Paul Kwan
Director, Valuations Qld
+61 7 3246 8870
Paul.Kwan@qld.knightfrankval.com.au

Marc Crowe
Director, Valuations WA
+61 8 9225 2521
Marc.Crowe@au.knightfrank.com

Nick Bell
Director, Valuations SA
+61 8 8233 5242
Nick.Bell@sa.knightfrankval.com.au