RESEARCH

AUSTRALIAN RETAIL INVESTMENT

MARKET OVERVIEW FEBRUARY 2015

HIGHLIGHTS

Despite being down on last year, investment activity for retail assets remains solid, totaling $6.78 billion over 2014.

Significant capital remains in the market, with the weaker investment in the sector more reflective of limited assets being offered to the market.

From an investment perspective, Neighbourhood Centres generated the strongest demand over the past 12 months, accounting for 31% of retail sales above $10 million.

KEY FINDINGS

Food retailing has led a resurgence in retail spending, with turnover up 5.0% over the year to November 2014.

Regional Centres continue to be highly sought after, however opportunities have been rare.

Sale volumes continue to be dominated by Unlisted/Syndicate funds, accounting for 45% of sales over the past 12 months.

Buyer depth is expected to remain solid over coming years, which is likely to place downward pressure on core market yields.

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OVERVIEW

Over the past 12 months, there has been a modest decline in retail sector investment. However, this is more reflective of a lack of available stock rather than weaker investor demand.

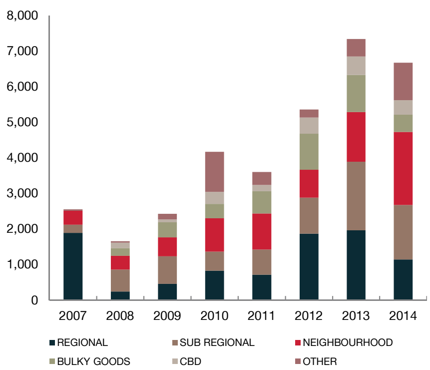
The past few years has signified an interesting period for the retail sector as moderate retail turnover growth coincided with a period of solid investment demand. This environment, coupled with the continued growth of online retail sales has ensured that landlords have had to evolve to keep up to date with consumer demands.

More recently, retail spending has improved, with consistent growth recorded since late 2013. Over the year to November 2014, retail turnover increased by 5.0% which fuelled investor demand for well located and good quality centres.

With growth in retail spending a key driver in the performance of retail property, the recent improvement has flowed through to asset values and yields, with a contraction in yields recorded for all sub-sectors over the past 12 months. A lack of available opportunities and resilient interest from offshore investors continues to underpin sales activity within the sector.

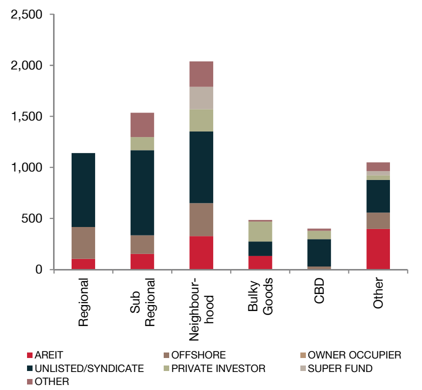
Investment activity for retail assets remains solid with national transactions trending 35% above the average recorded over the past five years. Following record levels of activity during 2013 in which sales totalled $7.34 billion ($10m +), investment in the sector eased moderately to $6.78 billion—an 8% reduction. However, this modest slowdown more reflects a lack of available assets being offered to the market rather than weaker demand with retail assets continuing to be highly sought after.

FIGURE 1
National Retail Transactions
By Centre Type ($mil) - $10mil +



Source: Knight Frank

FIGURE 2
2014 Retail Transactions
By Centre & Purchaser Type ($mil) - $10mil +



Source: Knight Frank
Note: Other includes Outlet/Tourism centres etc. (i.e. Mirvac's October 2014 acquisition of the Birkenhead Point Shopping Centre for $310 million).

The key investment feature over the past two years has been the gravitation towards Neighbourhood Centres as larger centres have become more tightly held. Over the 2014 calendar year, Neighbourhood Centres made up the bulk of retail centre sales where just over $2.1 billion worth of assets were exchanged (31% of total sales). In turn, yield compression has been most pronounced for the sub-sector, firming 44 bps over the past 12 months. The recent shift to Neighbourhood Centres reflects the growing attraction to retail centres with higher exposure to food, grocery and restaurant/café retailing, as these assets tend to be more resilient during a period of weak retail spending.

Notwithstanding the strong demand for Neighbourhood Centres, there remains solid interest for larger Regional and Sub-Regional Centres from investors seeking prime core assets. Over the past 12 months, investment in Regional and Sub-Regional Centres totalled $1.14 billion and $1.54 billion respectively.

On the whole, transactional activity continues to be dominated by Unlisted/ Syndicate funds, where transaction volumes from these buyers totalled $3.0 billion (45% of total sales) over 2014. Over the same time, investment from AREITs and offshore investors appears to have considerably slowed, down 16% and 45% respectively from the heights recorded in 2013.

During 2013, offshore investors were very active for Regional Centres (just under $900 million worth of Regional assets exchanged). However, the weaker investment during 2014 more likely reflects the selectiveness between asset grades and the relatively limited offering of prime grade assets (only three Regional sales in 2014). As a result, offshore investors are increasingly now seeking to acquire smaller Sub-Regional and Neighbourhood Centres.

RETAIL SALES

Following the recent surge in national house prices, retail turnover has shown an equivalent response with spending trending upwards over the past 12 months, particularly in NSW and Vic. The recovery has been underpinned by a combination of historically low interest rates and an increase in wealth levels brought about by the large gains in property prices. Additionally, the Australian dollar has moderated in recent months which has supported domestic retailers by making offshore purchases more expensive.

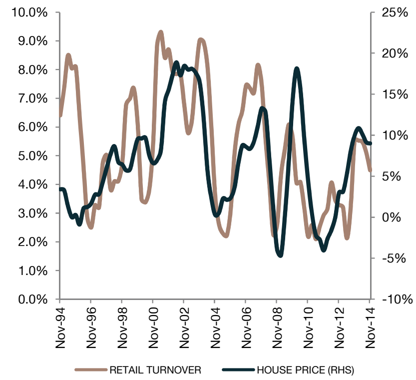
The improvement in spending has now been persistent for the past 12 months, where annual growth totaled 5.0% over the year to November 2014. In line with a decline in mining investment as projects enter their operational phase, the dominant resource states of Qld and WA have experienced growth considerably under the national average at 1.5% and 1.0% respectively over the past year, while growth has been driven by non-mining states.

NSW has led the way, with annual retail sales growth of 8.8%, followed by Vic (5.7%). Across the country, house price growth has been greatest within NSW and Vic, which accentuates the strong correlation between consumer spending patterns and house prices. As figure 5 suggests, the two are closely aligned.

FIGURE 5

Retail Turnover vs House Prices

Annual Growth—Australia (%)



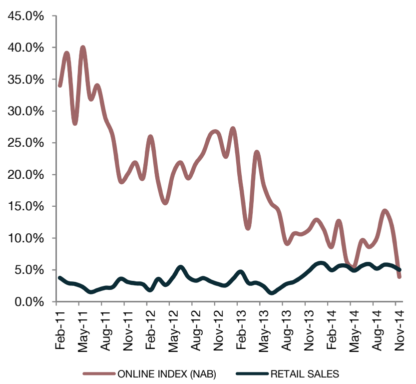
Source: ABS, Knight Frank

By category, retail turnover has been mixed with some sectors experiencing their highest levels of growth in years while others continue to underperform the broader retail market. Food retailing continues to be the benchmark with growth remaining above the more discretionary categories. The last five years has seen food retailing record average annual growth of 4.2% compared to 3.0% for non-food categories. Specifically, the upturn in residential building activity has led to robust sales in household goods retailing where annual growth in excess of 11% was achieved. Expenditure in cafes and restaurants (including takeaway services) has also been solid, increasing by 5.9%, while a pre Christmas recovery for department stores led to growth of 2.1% over the past 12 months.

FIGURE 3

Online Sales Vs Retail Sales

Annual Growth

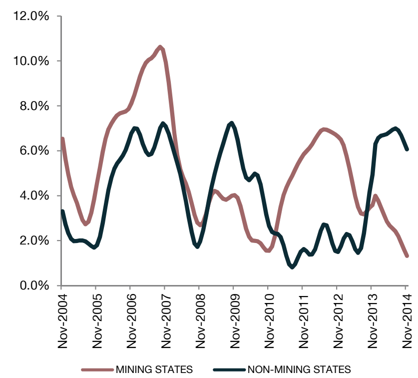


Source: ABS, NAB, Knight Frank

FIGURE 4

Retail Turnover

Annual growth (Trend) -Mining vs Non Mining

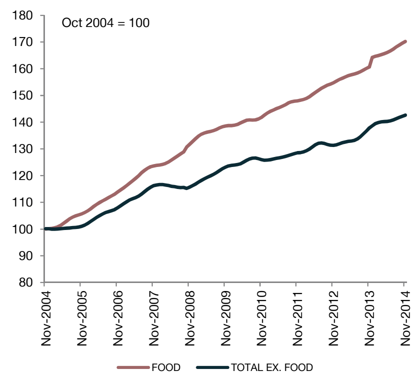


Source: ABS, Knight Frank

FIGURE 6

Retail Turnover by Category

Food Vs Non-Food—Australia

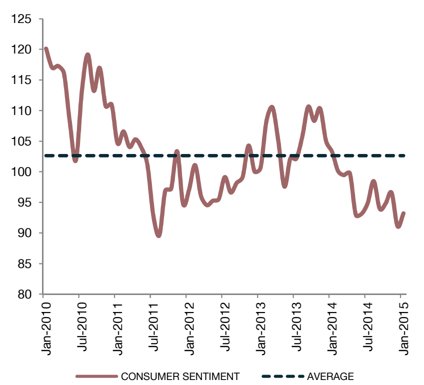


Source: ABS, Knight Frank

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. In recent years, growth in online sales has significantly outstripped growth in traditional retail spending, however more recently, online sales experienced a considerable slowdown, largely off the back of a weaker Australian dollar. According to the NAB Online Sales Index as at November 2014, online sales showed annual growth of 3.9%, down from 11.3% a year ago. In dollar terms, this rate of growth meant that Australians spent approximately $16.3 billion via online retail over the year to November, equating to 6.8% of total retail sales, slightly above the 6.4% recorded for the year earlier.

There remains several headwinds facing the retail sector with consumer sentiment remaining weak. According to the Westpac Melbourne Institute Index of Consumer Sentiment, consumer confidence increased 2.4% in January 2015 to 93.2. This result was a considerable improvement from the December result where a 5.7% decrease was recorded, however consumer confidence on the whole remains pessimistic. Consumers remain cautious following the May Federal Budget and weaker economic news. Meanwhile, wage growth remains subdued off the back of patchy labour market conditions which is likely to restrict spending levels over the short to medium term.

FIGURE 7
Consumer Sentiment
Monthly Index



Source: Westpac, Knight Frank

TABLE 1
Annual Retail Turnover by Category—Year to November 2014

	Food Retail	Household Goods	Clothing & Footwear	Department Stores	Other	Cafes, Restaurants and Takeaway	Total
NSW	9.2%	18.6%	2.0%	4.1%	2.1%	9.9%	**8.8%**
Vic	5.7%	13.2%	-11.4%	3.3%	3.7%	12.2%	**5.7%**
Qld	5.3%	9.0%	-2.7%	1.7%	14.9	2.6%	**1.5%**
WA	4.4%	-0.4%	-3.1%	-1.9%	1.2%	-3.2%	**1.0%**
Other	6.5%	3.6%	9.9%	-0.7%	2.1%	-0.1%	**4.2%**
Total	**6.6%**	**11.0%**	**-2.5%**	**2.1%**	**-1.7%**	**5.9%**	**5.0%**

Source: ABS, Knight Frank

A changing dynamic that has overshadowed the retail sector in recent years has been the shift in households attitude towards spending. Since the GFC households have re-adjusted their balance sheets by increasing savings and reducing debt. Consequently, since the heights of the GFC, the household savings ratio has remained high, averaging 10.2%. More recently, households have begun to increase their spending with the savings rate at its lowest point since December 2009 at 9.3%. This more favourable spending outlook comes in response to a combination of low interest rates and consumers feeling wealthier following large gains in dwelling values.

Although this higher rate of savings has been a short term challenge for retailers, a stronger financial position from increased savings and the recent gain in property prices presents a favourable viewpoint for the sector into 2015. This has been reflected in the improvement in spending over the past 12 months. Looking forward, retail turnover is expected to remain around the 10 year average during 2015 and into 2016, with low interest rates and rising wealth levels to provide scope for sustained levels in consumer spending. However as households continue to show a growing propensity to spend on services such as travel and health, non-discretionary categories such as food retailing are expected to continue outperforming other discretionary categories. Sluggish employment growth and patchy labour market conditions further support this outlook as it will remain at the forefront of consumers spending habits, thereby hindering sentiment towards the more discretionary retail categories.

NSW is expected to remain the standout performer, underpinned by the construction sector and benefiting from the lower Australian dollar. The recent increase in residential building is likely to see an uplift in retail turnover through the purchasing of household goods such as furniture and fittings. Similarly, retail spending in the resource dominant states of Qld and WA is expected to remain below the national average well into 2015.

FIGURE 8
Household Saving Ratio
Quarterly (%)

Source: ABS, Knight Frank

> "NSW to remain the standout performer in the Retail sector underpinned by the construction sector."

NATIONAL RETAIL TRANSACTIONS

REGIONAL CENTRES

The strong interest from investors seeking core ‘trophy’ assets saw buying activity for Regional Centres remain solid during 2014, following several large acquisitions amounting to $1.14 billion (3 sales). This total, however is down 42% from $1.96 billion recorded in 2013, though this modest decline has been brought about by a fewer regional assets being put to the market.

The largest Regional Centre sale during 2014 was the 50% acquisition of the Northland Shopping Centre at East Preston, Victoria for $496 million by GPT (GWSCF) from the Canada Pension Plan Investment Board. The sale represented the largest shopping centre transaction post GFC and highlights investor appetite for trophy retail assets.

Other notable sales include AMP purchasing a 50% share in Stockland Townsville for $228.7 million and the $416.3 million sale of the Mount Ommaney Shopping Centre (Qld) which was bought by a joint venture (JV) between Federation Centres and US based TIAA Henderson Real Estate. Notably, with the exception of TIAA Henderson Real Estate’s share in the JV with Federation Centres, sales activity has come from domestic capital.

In light of the recent transactions and solid investor demand, average core market yields for both Super & Major Regional Centres and Regional Centres are estimated to have tightened by approximately 25bps over 2014. The recent firming means that average core market yields range between 5.50% and 6.25% for Super & Major Regional Centres and 6.00% to 6.75% for Regional Centres.

SUB-REGIONAL CENTRES

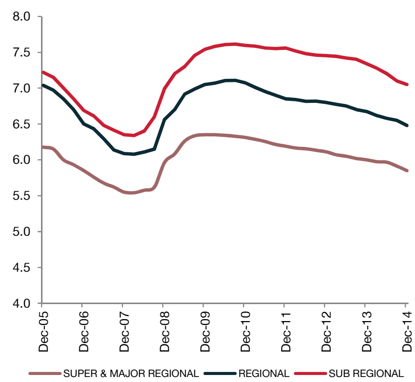
A lack of Regional Centre investment opportunities has created resilient demand for Sub-Regional Centres. In line with the majority of sub-sectors, investment activity has eased from its 2013 peak, however, there remains significant capital in the market, underpinned by Unlisted/Syndicate funds which represented approximately 60% of Sub-Regional sales during 2014.

The bulk of sales activity in 2014 has been concentrated in NSW and Vic, accounting for 28% and 39% of Sub-Regional sales respectively, while SA has experienced its best result in recent years. Over the year, investment in the sub-sector ($10m +) totalled $1.54 billion (21 sales), down 20% from the $1.93 billion recorded during 2013 (27 sales).

FIGURE 9

Average Core Market Yields

Super & Major Regional, Regional & Sub-Regional—Australia



Source: IPD, Knight Frank

TABLE 2

Regional/Sub-Regional Centre Retail Transactions

Centre	State	Price ($m)	Core Mkt Yield (%)	GLAR (m²)	Purchaser	Vendor	Sale Date
Regional							
Northland Shopping Centre (50%)	Vic	496.0	5.80	92,380	GPT (GWSCF>)	CPP Investment Board (CPPIB)	Apr-14
Mt Ommaney Centre	Qld	416.3	6.00	56,023	JV— Federation Centres & TIAA Henderson Real Estate	AMP Capital ^	Sep-14
Stockland Townsville (50%)	Qld	228.7	6.25	58,681	AMP Capital +	Stockland	Oct-14
Sub-Regional							
Arndale Central	SA	152.0	7.90	37,000	Armada Funds Management	Federation Centres	Oct-14
Golden Grove Village	SA	129.1	6.97	30,303	Challenger Life	CFS Retail~	Jul-14
Mildura Central	Vic	109.8	6.89*	20,048	Novion Property Group	Federation Centres	Dec-14
Shepparton Marketplace	Vic	70.6	7.00*	16,350	DEXUS (DWPF<)	Private Investor	Dec-14
Waurn Ponds Shopping Centre (50%)#	Vic	63.0	7.26	47,500#	ISPT Core Fund	Australian Unity Retail Property Fund	Jun-14
Sugarland Shoppingtown (50%)	Qld	59.3	7.50	22,759	Stockland	AMP Capital	Oct-14

Source: Knight Frank + AMP Capital Shopping Centre Fund > GPT Wholesale Shopping Centre Fund ^AMP Core Property Fund ~ Now called Novion * Initial Yield < Dexus Wholesale Property Fund #Sub-Regional at the time of sale, but recently expanded to become a Regional Centre with 47,500m² of retail space. The expansion was undertaken in a JV between Coles and Australian Unity Real Estate Investment (AUREI)

The largest Sub-Regional sale over the period was the SA purchase of Arndale Central for $152 million by Armada Funds Management. Other large sales included the $139.5 acquisition of the Waverley Gardens Shopping Centre as part of a portfolio sale between Mirvac and Blackstone and the recent sale of Mildura Central for $109.8 million.

Solid demand and recent sales has led to considerable firming of yields. Over the past 12 months, average core market yields have tightened 33bps, which is the largest contraction in the sub-sector since 2007. As a result of this firming, average core market yields for Sub-Regional Centres range between 6.75% and 7.25%.

NEIGHBOURHOOD CENTRES

From an investment perspective, Neighbourhood Centres have recorded the strongest volumes in the retail sector over the past 12 months, with centres that have high food and grocery exposure continuing to draw strong interest from all investor types. The food based nature of Neighbourhood Centres when compared to larger retail formats has aligned with superior growth in food retailing over the past five years. Similarly, the less discretionary nature of these centres means demand is more resilient when retail turnover is weak.

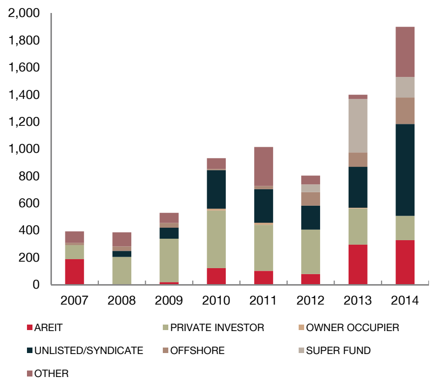
Over the calendar year 2014, sales volumes totalled $2.1 billion, which represents a 51% increase on the previous peak in 2013. After accounting for 15% and 19% of total retail asset sales during 2012 and 2013 respectively, Neighbourhood volumes as a proportion of total sales exceeded all other categories in 2014 at 31%. While NSW remains the focal point of sales activity, Qld's share of sales in 2014 increased significantly, totalling $635 million which is more than 2012 and 2013 combined.

Given their lower entry price, Neighbourhood Centres tend to appeal to a broader range of investor types.

Historically, private investors have been the most dominant purchasers, however, a lack of larger retail assets for sale over the past 12 months has meant that larger unlisted institutional funds have increased their purchasing presence for such assets. Over CY 2014, Unlisted/ Syndicate funds represented 35% of purchases.

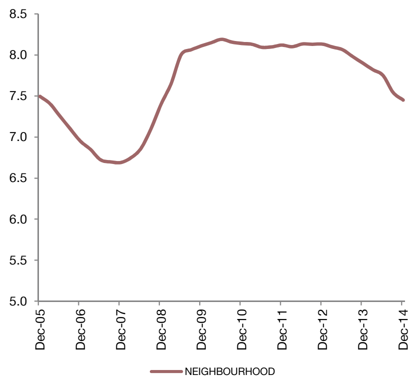
The largest Neighbourhood Centre sale over the 2014 CY was the December purchase of the Norwest Marketown Shopping Centre for $120 million by Malaysian conglomerate Mulpha. The 4.4 ha site has plans to be redeveloped into a mixed-use residential, retail and leisure precinct. Other notable sales include the sale of the Campsie Centre for $67

FIGURE 10
Neighbourhood Centre Transactions
By Purchaser ($mil) - $10mil +



Source: Knight Frank

FIGURE 11
Average Core Market Yields
Neighbourhood Centres —Australia



Source: IPD, Knight Frank

TABLE 3
Neighbourhood Centre Retail Transactions

Centre	State	Price ($m)	Core Mkt Yield (%)	GLAR (m²)	Purchaser	Vendor	Sale Date
Campsie Centre	NSW	67.0	8.61	13,041	Private Investor	Cobav P/L	May-14
Bathurst City Centre	NSW	62.6	7.19	12,241	Colonial First State (CERF>)	Oracle Estates P/L	Aug-14
Coomera City Centre	Qld	59.2	7.16	9,428	Charter Hall Retail REIT	Lewani Springs Resort	Aug-14
Marsden Park Shopping Centre	QLD	58.5	7.50	8,260	QIC Retail	Marsden Park P/L	Jul-14
Windsor Riverview Shopping Centre	NSW	50.0	6.62	7,923	JV - Dixon Advisory & Fort Street Advisers	Pirasta Pty Limited	Jul-14
North-West Plaza	Qld	41.2	7.75	9,493	EG Funds Management	Consolidated Properties	Aug-14
Northpoint Shopping Centre	Qld	36.5	7.13	6,868	Fort St Real Estate Capital	Hallmark Property P/L	Sep-14
Junction Fair	NSW	32.6	8.36	7,244	Fortius Funds Management	AMP Capital^	Nov-14
Muswellbrook Fair	NSW	19.7	8.50	8,916	Tipalea Partners	PPB Advisory	Dec-14

Source: Knight Frank > Colonial Property Enhanced Retail Fund ^AMP Property Income Fund million and acquisition of the Bathurst City Centre for $62.6 million. The centre was sold to ISPT, while the Australian Unity Retail Property Fund retain the remaining 50% interest.

Significant tightening of average core market yields for Neighbourhood Centres has also occurred over the past 12 months, firming 44bps over the year to September 2014. At present, average core market yields range between 7.25% and 7.75%.

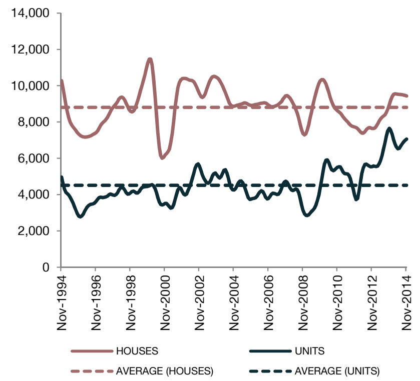
BULKY GOODS CENTRES

Expenditure growth for household goods has been the best performing retail category over the past 12 months, experiencing growth of 11.0%. This outcome has come off the back of a surge in residential building activity over the past two years, particularly apartment developments along the east coast of Australia. At the same time, the recent increase in house prices has been supportive of bulky good retailers as more and more households have a greater capacity to spend on household items such as furniture and garden supplies.

Nationally, residential building approvals are currently at peak levels, with almost 197,000 approvals made over the 12 months to November 2014—21.5% above the 10 year average. In line with annual turnover for household goods, dwelling approvals over the past year have been most pronounced in NSW and Vic, up 11.0% and 18.8% respectively.

Following the increase in retail turnover, investor demand for larger format retail centres has also picked up considerably over the past few years. 2013 marked the peak in sales activity at almost $1.05 billion, fueled by the sale and leaseback of several Bunnings stores. More recently, transaction activity has slowed in the sub-sector due to a more limited sale offering. Over the course of 2014, investment of $485.7 million was

FIGURE 12
Dwelling Approvals—Australia
Monthly by Number



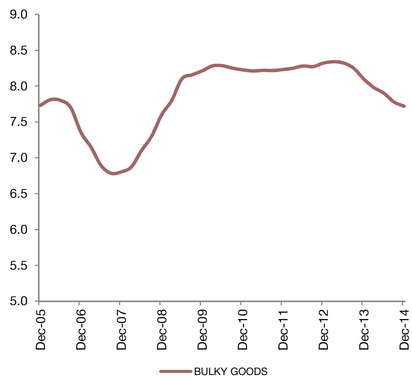
Source: ABS, Knight Frank

recorded, which is a 53% reduction from the peak recorded in 2013.

Investment activity over the past two years has been underpinned by a combination of strong interest from AREITs, Unlisted/Syndicate funds and private investors, while during 2014 alone, 41% of purchases came from private investors. The largest sale during 2014 was the January purchase of the Lincoln Mills Homemaker Centre in Vic for $57 million. Other large sales include the sale of the Lidcombe Power Centre for $51.3 million with plans to redevelop it into a Sub-Regional Centre called 'The Marketplace Auburn'. Portfolio acquisitions continue to be a key feature of the market following Charter Hall's purchase of five Bunnings Warehouse properties.

Similar to Neighbourhood Centres, average core market yields have firmed by 43bps over the past 12 months to range between 7.5% and 8.5%. Looking ahead, building activity is expected to remain solid, supported by low interest rates, high levels of pent-up demand (particularly Sydney) and confidence amongst developers. This outcome will augur well for bulky good retailers, where above average growth is expected to persist over the next two years.

FIGURE 13
Average Core Market Yields
Bulky Goods —Australia



Source: IPD, Knight Frank

TABLE 4
Bulky Goods Centre Retail Transactions

Centre	State	Price ($m)	Core Mkt Yield (%)	GLAR (m²)	Purchaser	Vendor	Sale Date
Lincoln Mills Homemaker	Vic	57.0	7.64	24,725	BWP Trust	Private Investor	Jan-14
Harvest Retail	NSW	54.3	7.20*	13,000	Rifici Group	Cbus Property	Nov-14
Lidcombe Power Centre	NSW	51.3	N/A	35,300	JV - APN Funds Mgmt & Newmark Property Group	Zac Fried	Jun-14
Lake Haven Home Mega Centre	NSW	40.5	8.81*	21,769	Altis Property Partners	Private Investor	Dec-14
Wendouree Homemaker Centre	Vic	27.1	9.25	18,606	BB Retail Capital	Australian Unity Retail Property Fund	Sep-14
Bunnings Warehouse Ballina	NSW	21.3	6.70	10,928	Private Investor	Wesfarmers	Sep-14

Source: Knight Frank * Initial Yield

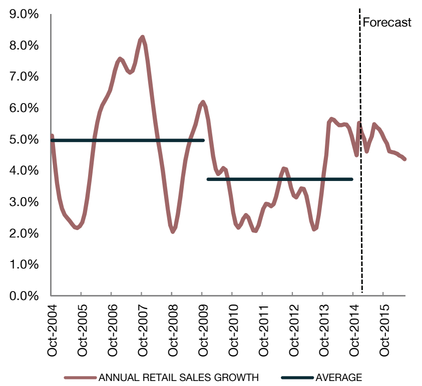
OUTLOOK

The outlook and scale of retail spending growth is dependent on the profile for housing interest rates and labour market conditions. The RBA target cash rate has been steady since July 2013 at 2.5% and indications suggest the cash rate will remain at similar levels until at least the end of 2015. Labour market conditions are expected to remain subdued, with a sustained decline in the unemployment rate not expected for some time.

In this event, retail turnover is expected to continue at its current pace over the remainder of 2015 before moderating in 2016 in response to a potential tightening of monetary policy and a modest increase in interest rates. Additionally, further depreciation of the Australian dollar is expected over 2015, which should further support an uplift in domestic retail sales.

With the significant amount of both domestic and global capital looking for investment opportunities in the market, it is likely that buyer depth for retail assets will remain solid, as the potential pool of buyers is significantly above pre-GFC levels. However, given the tightly held nature of Regional Centre assets, market opportunities are likely to remain relatively limited. This environment is likely to see investors look at other smaller sub-sectors while becoming more aggressive in their approach to secure retail assets. In turn, this will create downward pressure on average core market yields. Similarly, it appears that prime office assets are approaching the levels experienced during their recent low point in 2007. We expect a similar environment for quality retail assets over the course of 2015.

FIGURE 14
Retail Turnover—Australia
Annual Growth (%; Trend)



Source: ABS, Knight Frank

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