

# Improving prospects for the Australian retail sector

## Property Market Review

14 December 2009

- **Retail turnover remains solid.** Australian retail turnover rebounded strongly during the second part of 2009, primarily reflecting the Federal Government's fiscal stimulus packages, as well as historically low interest rates and a better-than-expected outcome for the labour market. Soaring consumer confidence also helped drive significant increases in the more discretionary categories of clothing, footwear and personal accessories as well as cafes, restaurants and takeaway.
- **Moderate supply conditions ahead.** Difficulty attracting pre-commitments and constraints on accessing credit in late 2008 and early 2009 has led to the scale back or postponement of new supply across markets/categories for completion in 2010. This is anticipated to change in 2011, where nearly one million square metres of new space is forecast to come online.
- **Rental growth and vacancy rates stabilising.** Anecdotal evidence suggests that the rise in vacancy may be slowing, as the run of positive economic news helped stabilise tenant demand. Growth in retail rents is anticipated to improve in the near term on the back of rising economic activity, as well as stronger tenant demand and falling vacancy rates.
- **Greater clarity on retail investment yields expected.** Retail investment yields appear to be closer to a peak, with the pace of yield-softening moderating in the September quarter 2009. Given the equity raised by the A-REIT sector during 2009, it is likely that institutions will emerge as net asset purchasers, which will help provide better guidance for retail investment yields.

**1. Introduction**

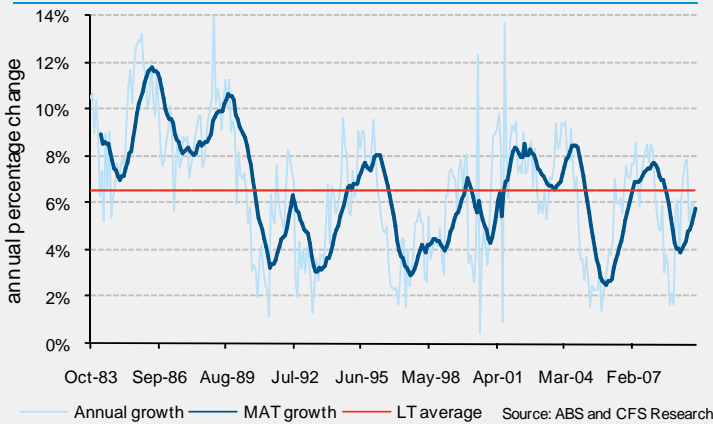
The outlook for the Australian economy continues to improve, with measures of confidence and business conditions suggesting that the economy is well into recovery. The domestic economy has been supported by pro-active policy action and a rebound in developing Asia's demand for mineral exports, especially China. Concerns have shifted towards removing some of the emergency policy settings put in place during the Global Financial Crisis with the Reserve Bank of Australia (RBA) lifting the cash rate by a total of 75 basis points to 3.75% at its final three meeting of 2009. It is anticipated that the RBA will continue to lift rates during the early part of 2010 as part of the process of returning policy to a more normal setting and as some inflation concerns return. Nevertheless, it is still likely that the risks to the outlook for the economy are on the upside; with growth expected to head back towards trend in 2010.

**Demand**

One of the main indicators used to measure retail demand is retail sales (or turnover). Retail turnover weakened significantly towards the end of 2008 (Figure 1), the height of the global financial crisis following the collapse of Lehman Brothers and growing fears the world was about to fall into a deep recession. Nevertheless, Australian retail turnover has rebounded strongly since then, peaking between May and June 2009, primarily flowing from the Federal government's fiscal stimulus packages, as well as historically low interest rates. A better-than-expected outcome for the labour market and soaring consumer confidence helped drive significant increases in the more discretionary categories of clothing, footwear and personal accessories as well as cafes, restaurants and takeaways, while non-discretionary categories like food remained relatively solid throughout late 2008 and 2009.

Retail sales have remained relatively buoyant during the second half of 2009, even as the impact from fiscal and monetary policy measures subside. National retail turnover increased by 0.3% during the month of October and is 5.6% higher than in October 2008. Food, which makes up 40% of retail turnover, grew by 5.6% in the year to October 2009 as well. Cafes and restaurants continued to grow strongly (+13.6%), while department stores showed a modest rise of 2.5% for the same period.

**Figure 1: National retail turnover (nominal)**  
Monthly rests ending October 2009

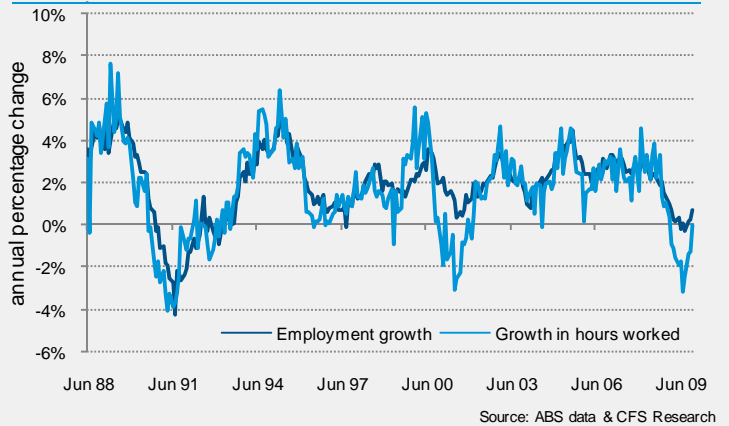


Looking forward, rising interest rates are likely to weigh negatively on retail turnover; however, the strength of the labour market is expected to partially offset this. As noted, one of the most striking things during 2009 was the resilience of the Australian labour market. Initially, the unemployment rate was projected to rise to over 8% - a figure not reached since the

late 1990s. Market forecasts were pulled back as economic activity and employment growth failed to contract as significantly as in other developed economies.

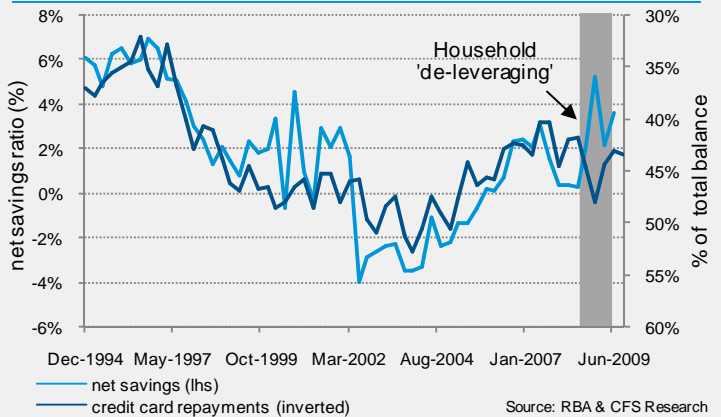
Momentum in the labour market appears to have shifted during the past three months to November 2009 with the unemployment rate edging down 0.1 percentage points to 5.7%. An additional 99,500 jobs were generated during this time, which is equivalent to employment growth of 3.7% at an annualised rate. Critically, 71,100 (71%) of new jobs were full-time, signalling that the period whereby total employment was maintained by moving full-time workers to part-time hours is ending. This is reflected in the substantial growth in total hours worked since July 2009 (Figure 2).

**Figure 2: Employment growth and aggregate hours worked**  
Monthly rests ending November 2009



One consequence of the global financial crisis has been a refocus on reducing leverage, both by households and businesses. One way this has manifested itself for households is via increased saving by consumers. Figure 3 plots the Household saving ratio<sup>1</sup> against credit card repayments as a proportion of total credit card balances.

**Figure 3: Net savings and credit card repayments**  
Quarterly rests ending September 2009



The two series have a strong inverse relationship (correlation of -0.82), with rises in one matching falls in the other. Even before the credit crisis Households (in aggregate) were increasing the amount of disposable income they saved. However, a recent rise in both the household saving ratio and credit card repayments signals household balance sheet de-leveraging and a change in households' spending attitude which, if it continues, could constrain retail turnover growth.

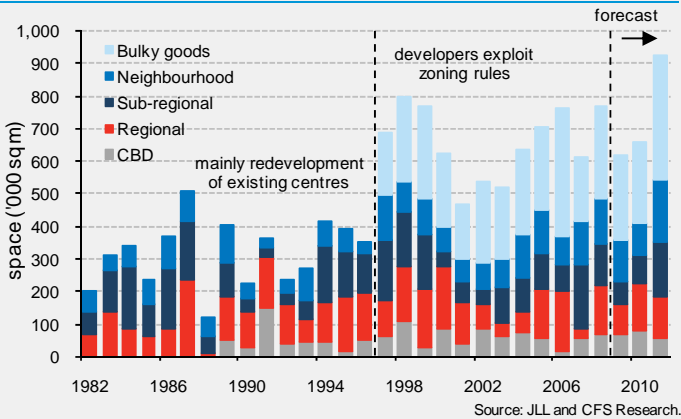
<sup>1</sup> Defined as the ratio of saving to total disposable income.

**Supply**

A relatively solid amount of supply entered markets during 2009 (Figure 4). Total retail completions were 615,806 square metres (sqm) for the nine months to September 2009, which is in line with the 10-year average of 638,507 sqm per annum. The Melbourne market (163,988 sqm) lead the way, followed by Adelaide (129,806 sqm) and Sydney (128,656 sqm). In comparison, South-East Queensland had a modest 94,977 sqm of stock enter the market, which was significantly down on the five year average of 196,316 sqm per annum. Bulky goods centres accounted for 42% of total completions followed by Neighbourhood centres (21%) during 2009. As at September 2009 there was around 762,571 sqm of supply under construction.

Difficulty attracting pre-commitments and constraints on accessing credit during late 2008 and early 2009 has led to the scale back or postponement of new supply across markets/categories during 2010 with only 657,965 sqm of stock projected. This is anticipated to change in 2011 where nearly one million sqm of new space is forecast to come online.

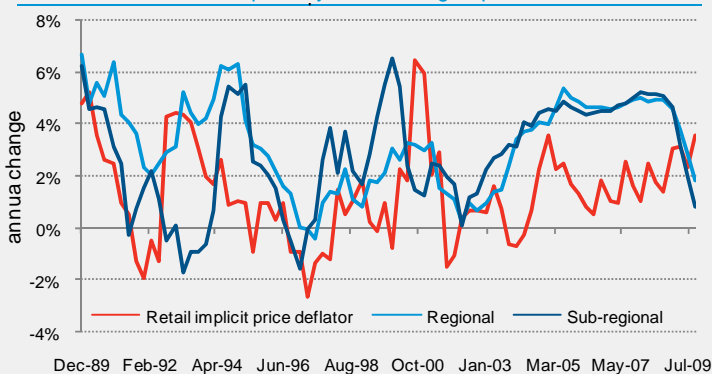
**Figure 4: Completion of retail space by centre type**  
Australian retail sector, period ending September 2009



**Vacancies and rents**

Retail vacancy rates have generally been rising during 2009. However, anecdotal evidence suggests that the rise in vacancy may be slowing as the run of positive economic news helped stabilise tenant demand. With their greater reliance on discretionary spending, Sub-regional centres are under pressure to maintain occupancy rates, while a disparity is emerging in Regional centres, with prime quality centres continuing to maintain relatively low levels of vacancy, while vacancy rates within secondary centres tend to be higher.

**Figure 5: Retail price inflation and nominal net rents**  
Australian retail sector, quarterly rests ending September 2009



Source: ABS, JLL & CFS Research

Rental growth has fallen significantly during 2009 (Figure 5) even as one of the main supports for rents, retail price inflation<sup>2</sup>, has continued to rise.

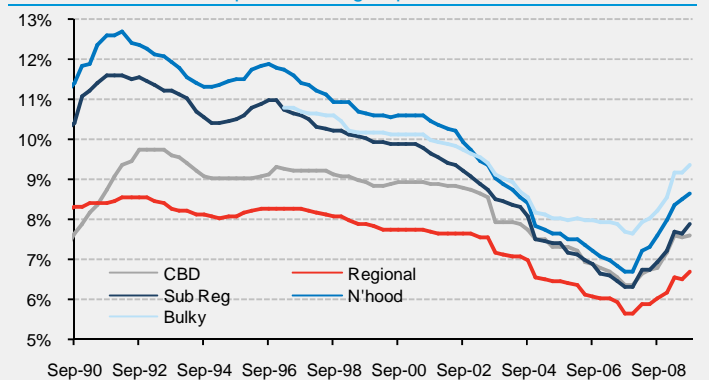
Growth has suffered from weaker tenant demand and rising vacancy rates, as well as greater discounting by retailers to shift stock. Regional centre rents rose by 0.3% on average in the September quarter 2009 and 1.9% over the year. As with vacancy rates, the better centres were able to achieve stronger growth; however, the average was pulled down by falls in secondary centres. South-East Queensland had the strongest growth (+2.8%), while Perth had the weakest (+0.8%) for the year to September 2009.

On average, rents grew 0.2% in Sub-regional centres during the third quarter of 2009 and by 0.8% for the year to September 2009. Melbourne Sub-regional centres performed better than the national average (+1.4%), whereas Perth (+0.5%) and Adelaide (+0.1%) underperformed the national average during the year to September 2009. Neighbourhood centre rental growth was flat in the September quarter and down 0.1% for the year to September 2009. Rental growth in the Bulky goods sector was also unchanged during the third quarter of 2009, following four consecutive quarters of declines. The stabilisation in rental growth for Bulky goods centres likely owes something to the rise in home buyer activity during the early part of 2009 from the increase in the First Home Buyers' Grant. Growth in retail rents is expected to improve in the near term as consumption growth continues to strengthen on the back of rising economic activity, as well as stronger tenant demand and falling centre vacancy rates.

**2. Investment performance**

Retail investment yields appear to be closer to a peak with the pace of yield-softening moderating in September quarter 2009 (Figure 6). Neighbourhood and Bulky good centres could show further yield decompression, while Regional centres have probably already peaked. Nevertheless, it is important to remember that there is still relatively little transactional evidence to support the assumed yields for higher valued centres. Given the equity raised by the A-REIT sector during 2009, it is likely that institutions will emerge as net purchasers in late 2009 and early 2010 which will help provide better guidance for retail investment yields.

**Figure 6: Average equivalent investment yields**  
Australian retail sector, period ending September 2009



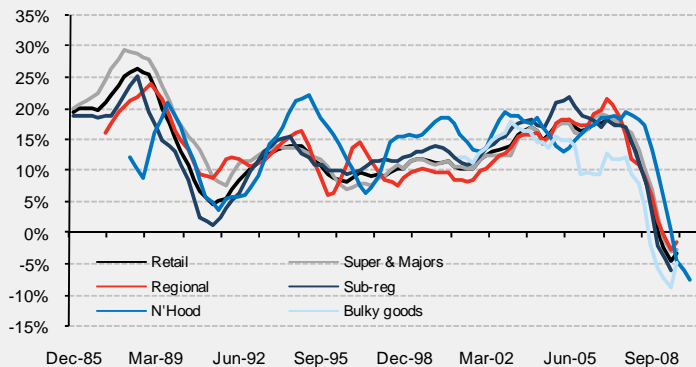
Source: JLL and CFS Research.

Evidence to suggest the worst is over for retail investment performance comes from looking at total returns across the sub-sectors as highlighted in Figure 7. As can be seen, the rate of

<sup>2</sup> Defined as the ratio of retail turnover in current prices to retail turnover in constant (chain volume measure) prices.

decline across the sub-sectors has bottomed. As capital values start to improve in the next couple of quarters (barring another negative shock) and with income growth remaining solid, total returns should return to positive territory, signifying a more optimistic outlook for retail markets nationally in the near term than was expected as little as six months ago.

**Figure 7: Total returns across retail sub-sectors**  
Annual percentage change, period ending September 2009



Source: PCA/IPD and CFS Research

Total returns rose modestly (+0.5%) across all retail assets on average in September quarter 2009. However, total returns were still down 3.3% for the year to September 2009. This was due to a 7.8% decline in capital values, while income returns remained resilient, growing by 6.8% during the same period. Regional centres performed outperformed relative to retail sector as a whole, with total returns falling by 1.5%. Whereas Bulky good centres underperformed the retail sector as a whole, with total returns of -4.9% for the year ended September 2009.

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