

Wallets are reopening and Australia's largest shopping centres are set to outperform

Property Viewpoint

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- The Australian economy is currently in the upswing phase and retail turnover growth is set to strengthen in the 2010-12 period; so what lies ahead for Australian retailers?
- From a property perspective, the mix of goods on sale will dictate how well shopping centres perform in the upswing.
- New research by Colonial First State Global Asset Management (CFSGAM) shows that regional and sub-regional shopping centres, with a relatively higher mix of discretionary goods, tend to outperform the broader market in the recovery.

In bad times, as you might expect, Australians tend to increase their expenditure on non-discretionary items and drop their spending on discretionary goods (and vice versa in good times). Fortunately, the recent downturn appears to be over, and consumer spending has started recovering gradually, slightly lagging the broader Australian economy. While this trend may have encouraged owners of retail property, does it indicate which shopping centres will outperform in the upswing? CFSGAM found that the largest, regional and sub-regional centres tend to outperform in the recovery phases, as they generally have more tenants offering discretionary goods, while Neighbourhood centres outperform in the tougher times.

In Table 1, the ABS retail trade statistics are segmented by the key industry sub-groups. These can be rearranged further into discretionary and non-discretionary goods retailing, and using weightings derived from the findings of Jebb Holland Dimasi¹, we have created the re-weighted performance indices for all centre types (refer to Figure 1). Based on the indices performance, retail sales at shopping centre types differ from the broader market activity, in line with the mixture of discretionary and non-discretionary goods traded (in the Jun-99 to Jan-10 period).

Table 1: Retail turnover: Industry sub-categories' share comparison across shopping centre types

Centre Type	Share of industry sub-categories in total retail turnover across shopping centre types shopping centres versus ABS broad market sample					
	Industry sub-groups					
	Food retailing (2)	Household goods retailing (1)	Clothing, footwear and personal accessory retailing (1)	Department stores/Discount Department stores (1)	Cafes, restaurants and takeaway food services (1)	Other retailing (1)
Regional	20.2%	8.1%	6.4%	37.4%	17.4%	10.4%
Sub-Regional	42.7%	4.5%	4.1%	26.6%	15.4%	6.8%
Neighbourhood	67.5%	5.9%	4.1%	0.0%	16.3%	6.2%
ABS (broader market)	39.8%	17.8%	8.2%	8.1%	13.7%	12.5%

Note: (1) Discretionary goods; (2) Non-discretionary goods

Source: ABS, JHD and CFS Research.

Importantly, growth in discretionary goods retailing tends to surpass that of non-discretionary goods in the recovery phases (refer to Figure 2) and vice versa². This is a result of a shift in the behaviour of consumers, who are generally willing to allocate a higher portion of their disposable income on non-essential retail purchases, in line with their perception



Author:
Dejan Radanovic

Investment Analyst

¹ Jebb Holland Dimasi (now Urbis) Shopping Centres in Australia, April 2001. We have assumed that the sub-group weightings have remained relatively unaffected (similar to the broader market).

² For example, the slowdown in retail sales growth in 2004-05 coincided with a downturn in the housing market and its impact on household wealth. Consequently, discretionary spending was negatively impacted.

of the stability of their income/jobs. Consequently, regional and sub-regional shopping centres outperform the broader market in the upswing phases as discretionary goods make up a significantly higher portion of their sales.

Figure 1: ABS versus Shopping centres
Comparison in turnover, base period June 1999 = 100

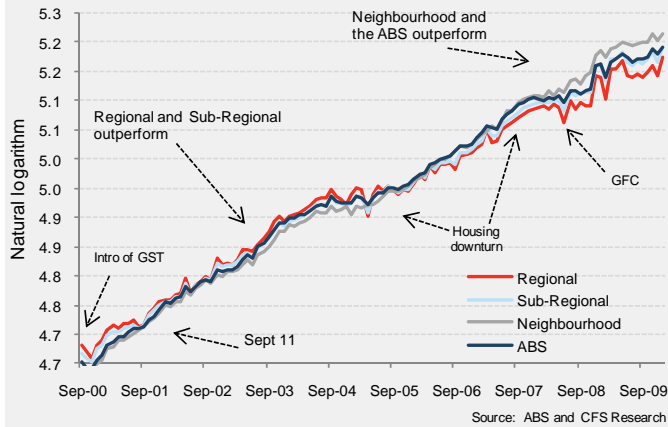
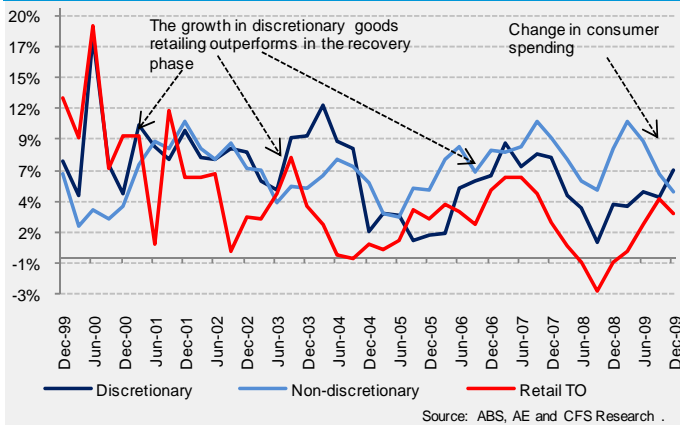


Figure 2: Discretionary vs. Non-discretionary goods
versus total retail turnover, period Dec-99 to Dec-09



Conversely, Neighbourhood centres and the broader market performed better in the recessionary environment, as they have a higher exposure to non-discretionary goods, which recorded lower variability in monthly growth rates (standard deviation of 0.95% in the Jun-82 to Jan-10 period) compared to discretionary ones at 1.70%. However, despite their underperformance in the downturns, regional and sub-regional centres managed to partly cushion the impact as a result of:

- better quality tenants that have capacity to absorb negative effects from changes in economic conditions via smaller profit margins and/or cost reductions; and
- consumers who, in a crisis, cut back on more luxurious items but do spend on small indulgences (the lipstick effect).

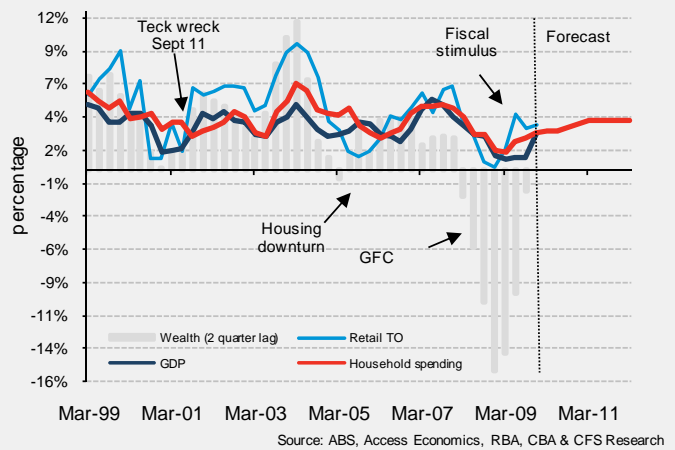
Also, in the downturns, sub-regional centres performed better than regional centres as they have higher non-discretionary goods retailing activity and a higher discount department stores component that usually benefits in turmoils.

2010-11 outlook

In line with anticipated stronger economic conditions in the near future, there are several positive indicators which are expected to set regional and sub-regional centres for outperformance including:

- an improvement in the labour market via a rise in full time employment and the number of working hours, which will boost consumer income levels and support consumer spending³;
- the anticipated continuing rise in population and subsequent demand for housing stock⁴ and household goods, which will assist the future of shopping centre retailing via a push up on demand;
- the restoration of household wealth (estimated to increase by approximately 10% in H209) is expected to support regional and sub-regional centres, as it increases both consumer confidence and household expenditure capacity⁵; and
- the introduction of personal income tax cuts on 1 July 2010 will further improve household accounts⁶.

Figure 3: Drivers of retail turnover: income and wealth
annual percentage change on quarterly rests



Retail turnover is the key component of household consumption spending, which is, in turn, an important part of economic growth. In the short term, household spending activity is expected to be in the upswing phase; rising strongly by an average of 3.5% per quarter, according to the Commonwealth Bank's forecast. This is in line with a strong GDP growth forecast for the same period (3.3% in FY10-12). Consequently, retail sales growth is anticipated to strengthen, matching these growth rates in this period.

Potential downside

While the combination of historically low interest rates, low inflationary pressure (via low fuel prices), and the substantial fiscal stimulus package (one of the largest in the developed world) kept retail trade positive in 2009, these factors are

³ In the seven months to March 2010, 214.9k jobs have been added, of which full time employment accounted for more than 60%. Also, while in Q1 2010 hours worked increased by 0.3%, they are yet to fully recover as they are still below the peak level.

⁴ In the 2008-09 period, Australia's population grew by 2.1%, the fastest growth in population over the past three decades, pressuring the housing market. In the past, demand for new housing outstripped supply, but, the considerable recent stimulus encouraged dwelling construction activity. The construction activity is expected to increase in the rest of 2010, supporting retail sales at shopping centres.

⁵ The improvement in household balance sheets is twofold: i) through the strong (12.7%) rise in house prices across capital cities over the past year; and ii) via the rise in the share market, recovering some superannuation losses. These are driving the spending activity.

⁶ The threshold at which the 30% marginal rate begins to apply is to be increased from \$35k to \$37k. In addition, the 40% marginal tax rate will decrease to 37%, for \$80k-\$180k income range. This will translate into the tax savings per week ranging from: around \$3 on a salary from \$20 to \$35k; \$8.65 for \$40-\$60k earnings range; and from \$5.77 up \$25 for someone earning from \$80 to \$180k a year, respectively. A portion of these savings will end up in retailers' pockets.

turning around in 2010. However, stronger economic growth and the improvement in labour, housing and share markets will likely offset the negatives which could potentially detract a strong retail recovery. We have already witnessed that despite recent monetary tightening, a disappearance of stimuli support, and a "pause" in retailing in February 2010,

retail sales have steadily increased by approximately 1.1% in the Dec-09 to Feb-10 period, supported by resilient household spending. And, as the market conditions continue to improve, the sword over retailers' heads will be gradually removed.

For further information

John Sears	Head of Research	+61 2 9303 3598	jsears@colonialfirststate.com.au
Luke Hartigan	Senior Investment Analyst	+61 2 9303 2625	lhartigan@colonialfirststate.com.au
Dejan Radanovic	Investment Analyst	+61 2 9303 6429	dradanovic@colonialfirststate.com.au
Ritesh Prasad	Investment Analyst - Infrastructure	+61 2 9303 7195	rprasad@colonialfirststate.com.au
Mary Culjak	Research Assistant	+61 2 9303 3518	mculjak@colonialfirststate.com.au

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