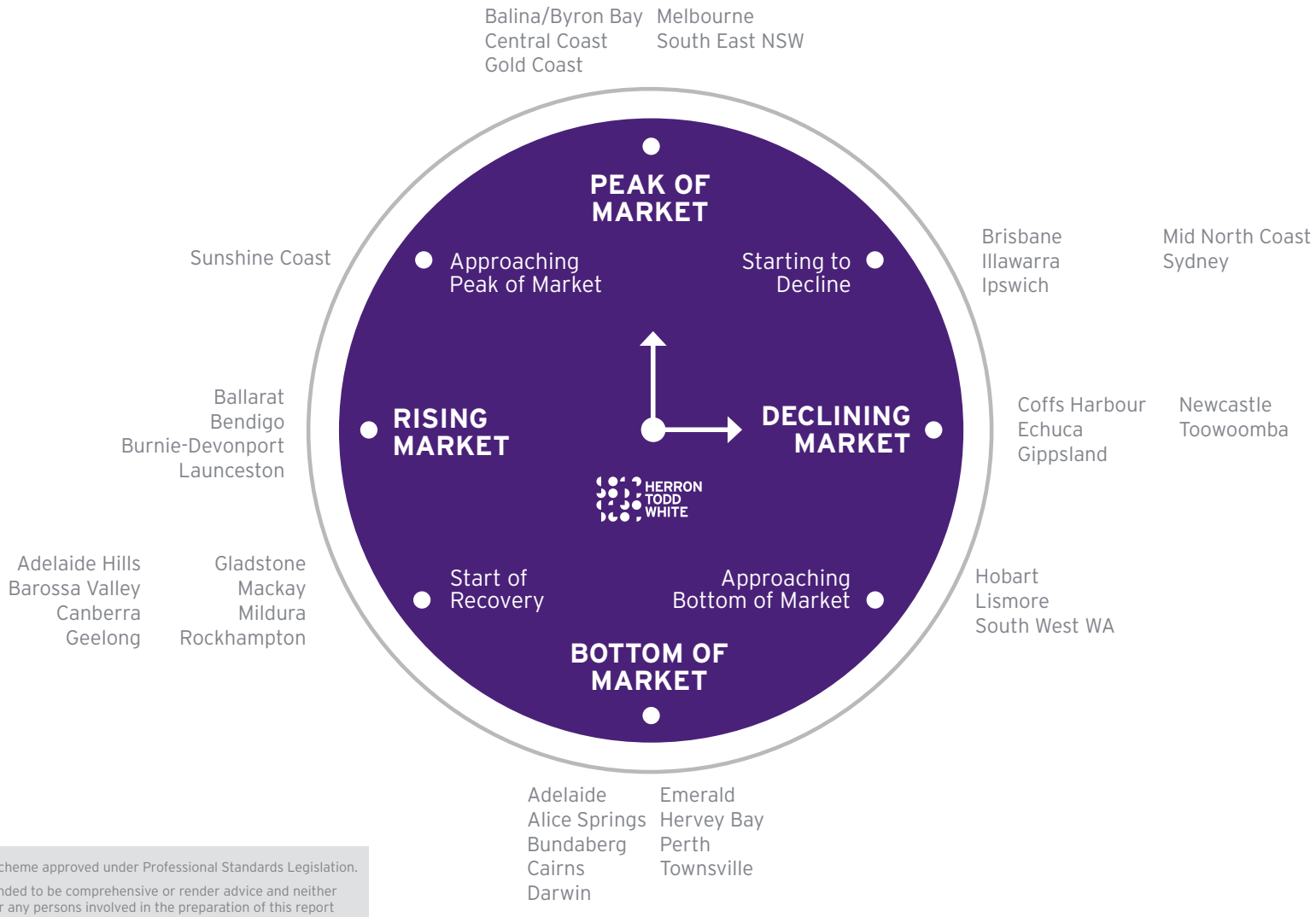
HERRON TODD WHITE COMMERCIAL

Retail

March 2020

National Property Clock: Retail

Entries coloured purple indicate positional change from last month.



New South Wales

Overview

As has been discussed by many, the retail sector has become one of this nation's most challenging industries – and the flow on effects to its property operators have been significant.

In the wake of major business closures and shifts in tenant demographic last year, what can we expect for the rest of 2020?

This month, our commercial teams provide their location-by-location outlook on the retail property sector for the remainder of this year.

Sydney

There is no shortage of negative media coverage for the retail sector and we are certainly of the opinion that there are tough conditions to come for the Sydney retail market.

The retail market generally performed well over the past few years as a result of demand from investors and the low cost of funding. That wave seems to now have passed and we anticipate that while there are still investors in the commercial market, they will be focused on other asset classes this year. There is concern that large chains and well-established businesses that have traditionally offered stable income are no longer considered to guarantee longevity and security for investors.

Some of the things we anticipate may happen in 2020 in the retail sector include a softening of capital values, a reduction in returns due to a softening of rental growth, moderate increases in supply, an increase in vacancy and an increase in incentives as landlords try to attract tenants. We expect these conditions and the general uncertainty in the market to result in a lack of demand.

In other areas, we have seen traditional retail properties adapting, with a focus on professional and health services, particularly at the lower end of the market.

In some instances, the market has been adapting to the changes that are coming. In some areas, we have seen a shift in traditional uses. As an example, we have seen a focus on food and beverage in some areas and centres. In some traditional strip retail precincts, we have begun to see a shift in expectations from landlords and a change in use. In these areas, the retail strips tend to outperform others more reluctant to change and in some cases, create a revival of sorts.

In other areas, we have seen traditional retail properties adapting, with a focus on professional and health services, particularly at the lower end of the market. The growing demand in this space has meant that landlords willing to adapt and alter their expectations have been able to attract good tenants.

Mixed use zoned properties with potential for redevelopment may hold up, especially if the recent increase in growth within the residential market continues and developers begin to return to the market.

Over the past year or so and as we got closer to the completion of the light rail within the CBD, we started to see an increase in demand from high end retail tenants. These high-end tenants were looking to secure prime locations in order to meet the growing demand for luxury goods, mainly from overseas tourists. In light of recent global events and media speculation over tourism this year, it will be interesting to see how and what impact this has on the higher end retail market.

Within the major shopping centres, demand and the wants of consumers has driven demand from retailers. Consumers are really looking to shopping centres for an experience. Food and beverage is dominating that demand. Centres that cater to this by offering a unique venue and plenty of variety are doing far better than those with a traditional layout and tenancy mix. We therefore expect that centres that adapt to the changing nature of the industry will continue to perform well.

Looking ahead, our outlook for retail in Sydney remains cautious. We expect a general slowing of the market and lack of demand from investors as we think most will wait to see the outcome of recent media coverage, global events and the collapse of many major retail chains.

Wollongong

We expect to see ongoing stagnant conditions in the retail sector in 2020 as the industry continues to be

impacted by online retailing and changing consumer behaviour. However, this is quite a broad statement.

While we recognise the challenges being faced in the broader industry, the weakness is not specific to our region and there is still good investor demand for quality retail assets underpinned by corporate leases as evidenced by the recent sale of Bing Lee Warilla for $3.2 million reflecting a passing and analysed market yield of 6.86% and a rate of $2013 per square metre (blended and inclusive of a warehouse storage component).

Overall bulky goods retail is performing well with vacancy rates low and rents holding up well. However, strip retail continues to be under pressure with no sign of improvement in vacancy rates, letting up periods, rents, incentives or tenant demand.

Lismore

The local retail market has been heavily impacted not only by the ongoing movement to online shopping but by the significant flood event in April 2017 which saw a number of businesses shut down. The take up of vacant space has been very slow.

The higher vacancy rates are likely to put downward pressure on rents over the coming 12 months. Ultimately this could impact value levels.

The local CBD retail trade is increasingly being dominated by food outlets, community groups and a small but growing number of office type uses within traditional retail space.

While the 2017 flood event remains a detracting aspect for ground floor space within the CBD, the flood diversion works at south Lismore (currently being constructed) could further reduce the risk of flood within the CBD (currently protected by a flood levee wall up to a 1:10 year event).

Despite the coastal market being reflective of a seller's market over the previous two to three years, our inland localities have been less buoyant.

Despite the coastal market being reflective of a seller's market over the previous two to three years, our inland localities have been less buoyant. The buyer's appetite for purchasing retail real estate remains cautious with the market still showing a level of maturity with limited demand for poorer quality properties in secondary locations while investors show very strong preference for fully leased assets with good lease profiles, particularly for national tenants or higher profile stable local tenants.

The exception to this rule is vacant lower priced properties which appeal to owner-occupiers which demonstrate lower yield more in line with national tenanted assets.

We envisage this trend to continue while interest rates remain low.

Ultimately the strength in the market can be relatively fragile and any increase in interest rates, decline in economic activity or significant decrease in market sentiment could see a softening in the market which could result in downward pressure on values.

Byron Bay & Ballina

The coastal retail markets have been more resilient with lower vacancy rates and stronger demand from tenants, particularly in higher profile locations, which has resulted in maintenance to upward pressure on rents.

Ultimately this is the result of a more dynamic and healthier tourist industry which has seen accommodation facilities experiencing higher occupancy rates.

The current significant concerns surrounding coronavirus are likely to impact the tourist market. This is likely to initially adversely impact markets dominated by the Chinese outbound market. The local market is not reliant on this component and as such is less likely to have any obvious downturn and the locality could experience a rise in the domestic tourist market as Australians opt against long flights or cruises etc.

We are expecting a steady as she goes with a stable retail rental market and value levels holding as supply and demand are likely balanced to a slight undersupply of quality investment product.

Coffs Harbour

The retail sector continues to experience sensitivity in rental levels, high vacancy rates and extended lease-up periods.

Despite various levels of the economy performing well, the demand for retail shopfronts is slow with a variance between the owner's asking rents and the rental level required to have a limited number of potential tenants commit to lease.

The vacancy level within the CBD main strip centre over the past 15 months has remained constant at around 12 shops or 15 percent vacancy in the main strip retail area. There is a low demand for secondary fringe locations unless the rental level is discounted to be cost-effective for local business.

Beachside retail in Woolgoolga and Sawtell are niche markets which appear to be performing at a stronger level albeit at far lower and affordable rental levels.

It is difficult to envisage any stimulus other than reduced rental levels or a complete reconfiguration of the property holdings (less than realistic) within the Coffs Harbour CBD.

The major shopping centres appear to be any prospective tenant's preferred option as they wish to operate within central centres with air conditioning, higher pedestrian flow and security in place, albeit that these centres are charging substantially higher rental rates and impose stringent conditions on opening hours which increases the cost to small business, particularly with Sunday trade.

The demand to purchase retail property varies depending on the market classification with investors and owner-occupiers active but usually with different criteria regarding the purchase of property.

Investors are focused on the strength of the tenant, terms and conditions of the lease and owner-occupiers are more interested in size, design, location and suitability for their business.

Whilst the strongest part of the retail market is the cafe, coffee and food sector, these businesses require a huge commitment, long hours and frequently battle competition, high wastage and wage costs. This often determines a limited capacity to pay higher rents or to sustain significant increases in rents. Investors remain attracted to retail property in the face of a low-interest rate climate as they seek superior rates of investment than those on offer from the banking sector and the share market.

Beachside retail in Woolgoolga and Sawtell are niche markets which appear to be performing at a stronger level albeit at far lower and affordable rental levels. The Woolgoolga market in particular is expanding with new developments planned or underway. Sawtell has long been established as a popular small retail centre with a high occupancy rate but has traditionally exhibited a comparatively lower level of rent. More recently, rents within the centre are edging upwards with most shop businesses focused on food and entertainment.

Victoria

Melbourne

The Melbourne retail investment sales market generally remained steady towards the end of 2019 with firm yields reflecting the limited availability of quality stock and solid purchaser demand. We have seen particularly strong results for well-located properties with long term leases to major national retailers and for those with longer term development potential.

We have continued to see varied results throughout the wider market. There have been a number of examples of heavily declining rents which, when coupled with already sharp yields, is resulting in downward pressure on capital values in some areas.

Our research indicates that financial institutions are placing an increased focus on factors such as security of income, lease covenant and length of remaining lease term for assessing serviceability of debt. As a result of the reduction in the borrowing power of purchasers, we are beginning to see signs of a slowdown in the constant price rises over the past five-year period. When on the market for sale, some retail properties are experiencing extended selling periods, particularly vacant retail assets and those in secondary locations.

As the wider retail market continues to evolve and adapt to the challenges, we are witnessing retailers looking to differentiate and reinvent themselves in the market. Online retailing continues to place downward pressure on bricks and mortar retailing however will likely continue to play an important role in a brand presence.

We are beginning to see a number of retailers rationalising their footprints by way of reducing store sizes and in some instances, closing underperforming or unprofitable stores.

According to the Australian Bureau of Statistics, retail trade in Victoria rose 0.3 percent from November to December 2019 with an annual increase of 2.8 percent from September 2018 to December 2019. Nonetheless, many retailers are expecting difficult operating conditions throughout the first half of 2020.

We are beginning to see a number of retailers rationalising their footprints by way of reducing store sizes and in some instances, closing underperforming or unprofitable stores.

The downward pressure on rents in suburban retail strips experienced throughout the majority of 2019 is expected to continue throughout 2020 with tenants continuing to seek short initial terms, sometimes as short as one year, with a number of further option terms which allows for flexibility in the short term but some security and certainty to retain the premises should the location prove suitable for the business. From a landlord's perspective, these flexible leasing terms are attracting tenants, covering operating costs and providing for reviews to market should the leasing market improve.

There is also a continuing trend of tenants being more aware of the impact that significant incentives have on net effective rents. Tenants appear to now be more open to negotiating lower face rents in lieu of rent-free periods or fit out contributions which provides more transparency for the tenant and landlord.

During 2020, the Melbourne retail investment market is expected to see varied results across different market segments. We are of the opinion that yields will remain stable for retail properties in strong retail locations such as the major strips in the Melbourne CBD and inner suburbs such as Collingwood and Fitzroy in addition to retail assets such as supermarkets which have long term leases to major national retailers and for properties with longer term potential for redevelopment. It is likely that yields may soften for retail properties in secondary locations, particularly within areas with low tenant demand and high vacancy rates.

As in previous years, the Melbourne CBD and inner suburban retail rental markets will continue to be heavily impacted by population growth, changes in consumer behaviour and varied consumer confidence. Some areas, such as Chapel Street, South Yarra and Bridge Road, Richmond will likely continue to experience high levels of vacancy as a result of the ongoing shift away from traditional retailing towards service and food based uses.

Outer suburban retail markets, in particular those outside established retail locations, will likely be impacted by larger operators who are opting for a more centralised model of retailing appealing to consumers demanding a more convenient and interactive shopping experience. Smaller retailers unable to sustain the higher rental rates typically demanded within modern centres will struggle to adjust to the larger number of vacating tenants along older retail strips unable to provide the convenient experience modern consumers demand.

Queensland

Brisbane

Retail continues to be the most challenging sector of the property market. An emerging reality is that there is simply too much retail available across Brisbane to service relatively flat levels of tenant demand. The oversupply is exacerbated by the ongoing growth and sophistication of the online environment and the significant cost advantages that online retailers enjoy compared to bricks and mortar retailers.

As a result, there is an increasing level of vacancy in areas previously considered as prime and a much greater level of focus on convenience, parking and exposure. This is causing a greater level of differentiation between prime and second tier properties which is evidenced in both rents and yields.

Issues such as decreasing availability of parking, the growth of delivery services and the higher costs of living generally have eaten into the profitability of a number of café precincts in the inner suburbs of Brisbane. Previously strong locations such as Bulimba, Nundah, Portside, Given Terrace, Racecourse Road, Park Road, Stones Corner, Coorparoo and Windsor in particular are seeing higher levels of vacancy and increasing levels of tenant turnover. For some of these precincts, recovery is likely to take many years.

Quiet Café Precincts Source: Kgbo, Wikimedia Commons

On the investment front, buyers are increasingly aware of the retail headwinds and have become increasingly cautious.

On the investment front, buyers are increasingly aware of the retail headwinds and have become increasingly cautious. They are more closely examining lease covenants, lettability and sustainability of rent levels before committing to purchase. Coupled with this, the inability to replace strong retail assets is leading to a diminishing supply of good quality stock for sale and lower levels of sales accordingly. As a result of this caution there is a clear divergence in yields emerging between good quality, well leased property and those with greater cash flow uncertainty. For prime sub $5 million investment properties, yields have continued to tighten whilst yields for second tier properties are stagnant at best.

For strong convenience retail properties, yields are generally in the 6% to 7% range but may achieve under 6% for strong well leased inner-city properties.

Good quality neighbourhood centres anchored by Coles and Woolworths are highly sought after with investment yields holding in the 5.75% to 6.75% range. These centres are considered to be reasonably recession and future- proof.

For sub-regional shopping centres, there are more sellers than buyers at the present time and markets are continuing to soften. The exposure of these centres to fashion and discretionary retailers is a significant drag on rents and saleability, however these market conditions open up opportunities and there are private investors scouring the market for opportunities to purchase and value add. There is however still the potential for ongoing diminution in rent levels for existing tenancies, and buyers are very cautious. Yields for these centres are showing a wide range and now touching over 8% for second tier properties.

Indicative yields

6% to 7%
Convenience retail

5.75% to 6.75%
Neighbourhood centres

>8%
Second-tier, sub-regional

In the CBD retail markets, conditions remain soft albeit that there is long term optimism in the

market due to the major infrastructure projects underway.

Rents across all retail classes are stagnant at best and incentives are increasing, particularly where there is significant vacancy.

The headwinds in retail are likely to be long term, with the likelihood of further pain.

Gold Coast

We are barely into a new decade and already Australia has been battling the extremes of drought, fire and floods, not to mention the threat of a major virus outbreak.

Apart from these extreme events, other challenges faced by Australia include the struggling retail sector, which flows on to the retail property market. The Gold Coast retail market is no different.

Stagnant wage growth and changing spending habits have been major contributors to lacklustre retail performance, while the increase in online shopping has had an impact on traditional bricks and mortar retailing. Further, many established retail centres within the Gold Coast's suburban areas have been impacted to some degree by the increase in online retailing, as well as restaurants and cafes.

In general, throughout 2019 there was increased stress on retail tenants on the Gold Coast, resulting in downward pressure on rents and upward pressure on incentives. A similar situation is expected throughout 2020. Landlords should consider rental affordability rather than purely the rate per square metre achievable and should

QLD GC Pimpama Service Centre Source: HTW

carefully weigh up the pros and cons of having a tenant in place at an affordable (although possibly lower) rental, versus achieving a higher rental with greater risk of tenant failure.

The global retail landscape is changing and local retailers and property owners must be aware and adapt as best they can. For retail to succeed in the future, some level of reinvention will be required. Locally, broad examples include the growth in quality cafes and restaurants in the suburbs on the southern Gold Coast, the creation of a China Town within Southport and on a more general scale, the increased number of convenient, drive-through cafes and food premises. Perhaps the number of retail services could increase also, as these are harder to replicate online.

The one saving grace is the current historically low interest rate environment, which commentators predict will stay lower for longer. Therefore, while rental levels have been impacted, yield levels have firmed and investor appetite for a return on investment is strong, helping to protect property values.

For retail to succeed in the future, some level of reinvention will be required.

The following case study is indicative of the strong results being achieved for quality retail investments, with recognised tenants and long WALEs. The Pimpama Service Centre sold in September 2019 for $16.35 million, reflecting an analysed yield of 5.81%. It was purchased by a high net worth private investor after an extensive marketing campaign. This is a modern service station and fast food complex completed in 2018, located within a developing retail precinct at Pimpama on the northern Gold Coast. It is anchored by a United Petroleum service station and there are five fast food tenancies, including Carl's Jr, Red Rooster, Pizza Hut, Zambrero and a Chinese restaurant. The WALE equates to 11.27 years (by income).

We consider that strong demand from investors for quality retail investments on the Gold Coast will continue throughout 2020, with the low interest rates and desirable location attributes maintaining yields at firm levels.

In terms of overall retail property values, we consider that the weaker rental market will be offset to some degree by the firm yields being achieved. However, for long term success, it will be imperative for all stakeholders to carefully monitor changing retail and cultural trends, both locally and abroad and to adapt as best they can.

Sunshine Coast

The Sunshine Coast has a number of different retail markets. These range from local townships, older retail strips, to some of the most sought-after retail real estate in Australia at Hastings Street, Noosa Heads.

As a result, it is very difficult to predict a general retail market sentiment across the region.

Towns such as Beerwah, Cooroy, Tewantin and

One of the continued themes we are seeing in the market is the interest in well leased assets.

Maleny that service local areas have seen limited rental growth, though typically have also seen limited vacancy over the past 24 months. Sales that have occurred indicate a general confidence from local investors in these areas with sales generally from circa 6.5% to 8.0% in that time.

Older retail strips such as Brisbane Road, Mooloolaba, the Nicklin Way along Kawana, Aerodrome Road at Maroochydore and Bulcock Street at Caloundra have shown far higher levels of volatility. Vacancy levels have fluctuated in these areas, although Council streetscape works have impacted along Bulcock Street. Now these works have finalised, we are seeing some renewed interest from local tenants.

6% - 8%

Mooloolaba Esplanade yields (108/19)

An interesting sale from January 2020 of 106 Brisbane Road, Mooloolaba has indicated the continued strong demand from local investors for well leased local strip assets with a strong WALE. This property sold for circa $2.3 million with seven local tenants in place at a WALE of 1.95 years, indicating a yield of 6.02%. This asset had an even spread of risk across the asset with no anchor style tenant.

Our marquee tourist style strips have also fluctuated during 2018/19. Mooloolaba Esplanade has had yields from 6% to 8% depending on the size of the asset and strength of lease. Larger strata titled holdings with limited lease term left have been at the upper end of this yield range, however sales in Hastings Street have continued to firm in that time with recent sales with strong leases in place indicating yields of sub 5% and values of over $50,000 per square metre.

One of the continued themes we are seeing in the market is the interest in well leased assets. While this is not new, there is a definite flight to better quality stock with secondary assets being more difficult to sell and often seeing a discount. Another impact is larger single tenant style space being priced with higher risk given it is difficult to secure tenants with quantum of rentals over $100,000 per annum in the current market.

However, with continued low interest rates predicted, it is likely that yields will remain strong in this market during 2020. This is despite the threat of online retail sales and failure of a number of large retailers over the past 12 months.

Toowoomba/Darling Downs

Similar to the national retail market, the Toowoomba CBD retail market has faced some challenges over the past few years. The major increase in online shopping has played a crucial role in this. In Toowoomba, the redevelopment of Grand Central Shopping Centre by QIC has impacted CBD retail occupancy rates. Grand Central has attracted some CBD retail tenants to the newer tenances in the centre, as well as attracting national and international brands that were previously not present in the local market. This has increased competition for small retail business owners.

According to a 2019 Ray White Commercial survey, the vacancy rate in the Toowoomba CBD is approaching 19 percent. The service industry is occupying the largest market share, with over 28 percent of properties within the CBD being leased to the service industry. Retail property owners can adapt to this swing by shifting their target market to the service industry, targeting users including hospitality services, real estate agencies and financial and legal services. We may see Toowoomba's CBD slowly transform into a food and service based hub, with traditional retail stores concentrated in the major shopping centres and bulky goods precincts. Subsequently, CBD retail rental rates are likely to come under pressure during 2020.

19%

Toowoomba CBD Vacancy rate

28%

CBD space leased to the service industry

We note that due to the recent development of both convenience and neighbourhood centres, there is more retail space available within the local Toowoomba market than ever before, therefore competition for tenants is strong and vacancy rates have increased. There has been strong growth in franchise food outlets, which have underpinned new convenience centres with predominantly food related tenants.

Townsville

The retail market in Townsville during 2020 is likely to maintain its status quo with the greater economic climate in the retail sector making for tough conditions.

Generally speaking, we are seeing a firming in yields in the broader retail sector, however there appears to be limited potential for rental growth in the current environment and a higher risk of

increasing vacancies on the back of looming lease expiries with no current commitment to re-lease.

Ageing neighbourhood centres with a single anchor tenant will likely present a higher risk due to capital expenditure requirements and cash flow volatility. The potential for redevelopment of these centres in the current market is also limited.

The smaller sub-neighbourhood centres offering a mix of fast food and drive through options are likely to remain the retail flavour during 2020.

Cairns

The Cairns retail property market passed through the bottom of the cycle during the course of 2014, but the limited recovery thus far means that the retail property market remains relatively flat. It must be also said that retail property sales in Cairns are extremely sporadic, with most sales involving mixed use retail and office buildings or tenant buyouts of single premises.

The level of general commercial property sales in Cairns, inclusive of retail and commercial office premises, highlights that activity in the Cairns commercial market remains well below the pre GFC levels. Sales volumes have been gradually rebuilding, but are still only averaging around 100 sales per annum. Median prices paid specifically for strata titled premises have increased mildly over the past several years, but our general impression is that prices per square metre of floor area are mostly stable within the $2,500 to $4,500 range.

High exposure CBD retail space remains reasonably well occupied, but vacancies are more noticeable in the lesser exposure locations and on the CBD fringe. Rents have remained generally stable, showing ranges of $600 to $800 per square metre per annum for prime CBD space and $1000 to $1750 per square metre per annum in key tourist precincts such as the Cairns Esplanade.

INDICATIVE RENTS

Prime Cairns CBD
$1000 to $1750/sqm

Cairns CBD Fringe
$600 to $800/sqm

Blue chip retail located within the main Esplanade tourist strip as well as the CBD show reasonably low vacancies, although there is also limited demand from new businesses. There remains good investor demand for well leased properties which rarely come onto the market.

The most notable recent retail sale was that of the Katies Centre, a 1100 square metre site situated on the very highly exposed corner of Abbott and Shields Streets. The site was improved with an old single level retail building of approximately 975 square metres and sold for $7 million. The building has since been refurbished at considerable cost to as new with most of the building leased to TimeZone.

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The Cairns retail property market overall has experienced little change over the past 12 months and is expected to see little change in the coming year.

Rockhampton

We expect a continuation of challenging leasing market conditions within the retail sector throughout 2020.

The bulky goods retail market had been dominated by the sale in August 2019 of the Bunnings site in Rockhampton for $43.5 million at a reported yield of about 6%, however as 2020 begins we note that agents are advertising two significant sales.

The Fantastic Furniture building, which is subject to a lease, is reported to be under contract at a yield below 8% and the ex-Joyce Mayne building is also reported as being under contract and has been subject to long term vacancy. In this bulky goods retail space, we expect 2020 to bring a renewed push to find occupants for both the ex Joyce Mayne and the ex Bunnings sites which are both within the Yaamba Road bulky goods precinct.

We note the opening of Rockhampton's first Aldi supermarket in 2019 and many are hoping their much anticipated northside store will follow in 2020.

In the neighbourhood and smaller regional centres, we note some significant vacancies. The success of the neighbourhood shopping centres has more recently been dependent on the presence of substantial anchor tenants (ie Woolworths, Coles, IGA) and the affordability of the asking rental. While there are significant vacancies in some centres, it will be worth keeping an eye on Allenstown Square. We are aware that the owners have secured a substantial number of residential properties immediately surrounding the centre over the years and demolition and house removal

works are nearing completion. There have not been any public announcements regarding the owner's plans for further expansion or redevelopment of this site, however we anticipate this may come to light in 2020.

CBD retailing remains difficult as evidenced by the significant vacancies in the precinct however we note the construction of the new Rockhampton Art Gallery on Quay Street at a cost of $31.5 million. It is the Council's hope that the gallery will be one of the main stimuli in the regeneration of the Rockhampton CBD. The new gallery will be nestled within the Riverside Redevelopment and will contribute to the life and atmosphere of the region. Construction is expected to be completed mid 2021.

Gladstone

We expect a continuation of challenging leasing market conditions within the retail sector throughout 2020 and anticipate little change to the Gladstone retail property market in the next 12 months.

Wide Bay

It has been business as usual for Bundaberg and Hervey Bay's retail property markets. Vacancies have been stable, rents have been solid and supply of new retail premises has been slow and calibrated not to over supply the market.

Secondary retail premises with large floor areas are still under pressure with very few tenants seeking large retail showrooms in secondary locations. The continuation of development along Main Street in Urraween and Pialba and the slow take up of lots in Kensington Bundaberg could see further diversifying of land uses which is a big factor in attracting land sales in retail areas.

Something to keep an eye on will be the impacts the Hinkler Deal projects could have on the traditional retail centres in Hervey Bay and Bundaberg. The Fraser Coast Regional Council has purchased properties towards the northern end of Main Street in the traditional retail area of Pialba for the proposed redevelopment of the Hervey Bay CBD and Bundaberg Regional Council has begun the process for de-maining Quay Street in the Bundaberg CBD for the redevelopment of the riverside precinct.

Mackay

We expect a continuation of challenging leasing market conditions within the bulky goods retail sector throughout 2020. Recent evidence suggests attractive incentives are now becoming common and in some cases are masking a decline in effective rents which now range from around $230 to $260 per square metre per annum gross for large format tenancies of 400 to 500 square metres in established retail complexes.

CBD retailing remains difficult as evidenced by the closure of Kaytown Shoes in Sydney Street after 54 years because of strong online and shopping centre competition. Advantage Chemist has also vacated their large CBD tenancy in Sydney Street and has opted to rebrand as Chemist Discount Centre in a fringe location.

Property investments associated with non-discretionary retailing (groceries and fuel) are expected to remain in high demand throughout 2020. With lower interest rates, we expect that yields for well anchored neighbourhood, regional and sub regional shopping centres and lessors' interests in service stations could firm throughout the course of the year if any are offered for sale.

Something to keep an eye on will be the impacts the Hinkler Deal projects could have on the traditional retail centres in Hervey Bay and Bundaberg.

South Australia

Adelaide

There's no shortage of doomsayers when it comes to the retail property sector, as retail trade continued to struggle in 2019. Transactions of retail properties also hit lows throughout last year as investors became pessimistic about the sector, with sales volumes falling 22% on 2018 levels. While the sector may be struggling overall; there are some shining lights in what looks a difficult transition period for retail property. In essence, we are witnessing the retail sector attempting to adapt to the changing consumer patterns arising from the growth of e-commerce and the online retail marketplace.

It's evident that adaptation is going to be key moving forward – the centres and retailers that can welcome and adapt to change will excel, or at least keep their heads above water, while those who can't will continue to struggle. Online purchases currently account for 17% of non-food retail sales in Australia and 9% of total retail sales – and this number is only going to grow. Whilst we believe it is important not to overstate the impact of the online domain, it is equally important not to underestimate it – and retailers need to adapt to survive. Property owners will need to embrace the online domain, shifting some of their sales and services online whilst simultaneously lowering overheads at their brick and mortar stores.

The trouble highlighted in retailers is for non-food goods – apparel, footwear and general merchandise – where it is easier, more convenient and often cheaper to purchase online. Food and grocery sales only account for 3% of online purchases, meaning that supermarkets are here to stay as anchor tenants for a while yet. Retail hubs are likely to take advantage of the recent growth in the food sector, with more cafes and restaurants popping up in hubs to draw tenants in, and then hopefully entice them into spending money in the specialty stores.

-22%
Sales volumes
2019 vs 2018

Amazon Hub locations are beginning to pop up around Australia; essentially a click and collect service where consumers can pick up parcels ordered online at a self-serve Amazon locker, as opposed to having it delivered to their home. Delivery lockers are enabling larger centres to transform and become places where people consume services and experiences, as opposed to places where people simply purchase goods.

There's still room for rental growth and capital gains in the Adelaide retail property sector, however at lower levels than will be evident in the industrial and office sectors. Interest rates are forecasted to drop, potentially twice throughout the year, and as a result of this we will see some more capital gains for property, yet with further yield compression across the board.

The retailers that continue to outperform others are the food retailers – cafes, restaurants and takeaway food services. As mentioned, we continue to see strong performance for retailers that can't be replaced by the online domain, however retail hubs and complexes need to be careful to avoid excessive inter-competition between food retailers. Furthermore, the recent exit of Kaufland from the Australian market has further enhanced the outlook for Australia's supermarket giants. The supermarket oligopoly of Woolworths, Coles and Foodland can now invest in assets with more assurance that the newcomer isn't going to take a portion of their market share.

Finally, it's no secret that department stores are feeling the pinch after the recently announced closure of Harris Scarfe stores around Adelaide. Furthermore, consumers are placing more emphasis on the presentation of retail centres and more emphasis on shopping as an experience. This is why we are seeing centres and main streets such as Burnside Village and the Norwood Parade plan developments to update their offerings. Retail centres and strip shops that are not well maintained are going to struggle. In this day and age, constant refurbishment is required to keep shops and complexes updated, and to keep foot traffic coming through the door.

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Western Australia

Perth

The retail property market in Perth continues to face challenging conditions. Demand for retail space remains hampered by restrained consumer spending coinciding with the state's sluggish economic performance. Additionally, online retail spending continues to grow rapidly and apply further pressure on the Perth retail market. Overall, despite some renewed optimism in the resource sector, confidence in general remains depressed.

The above has translated generally speaking to rental rates for retail premises experiencing a downward trend over the past 12 months with incentives in the form of net rent-free periods or fit-out contributions prevalent.

Our team continues to field enquiries from tenants struggling to meet rental payments for lease agreements negotiated in more buoyant times. Landlords are being faced with the option of re-negotiating lease terms to maintain occupancy or alternatively, risk extended periods of vacancy. These conditions are more prevalent in secondary and suburban strip locations, although it appears that prime CBD mall and high street locations including Oxford Street, Leederville, Beaufort Street, Mount Lawley and Bay View Terrace, Claremont are now beginning to experience a similar situation with vacancies becoming commonplace.

Investment grade retail property such as neighbourhood shopping centres however remain a highly sought-after asset. Yield compression is evident, largely driven by the low prevailing cost of funds in the current debt finance market and despite the general malaise that continues to impact the wider Western Australian economy including softening rentals and a steady stream of business failures and receiverships.

However, there are a certain number of key metrics that informed investors consider, relating to length of remaining lease term, financial strength of the tenant(s) and locational attributes, as investors take advantage of the spread between the low cost of debt and large format retail investment yields. Where all or a majority of these metrics are satisfied, very tight yields are being achieved in the current market. Assets that do not possess these key criteria are however less sought after and often transact at a much higher yield reflecting the greater tenancy risk.

5.00% TO 6.25%

Investment-grade retail sale yields 2019

In defiance of the above however, sites in the aforementioned high street locations remain keenly sought after despite the level of tenancy risk. This is a function of the scarcity of sites offered to the market in these locations and the high underlying land value. Yields for similar sites below 5.5% are not uncommon.

In respect to investment grade retail transactions, there were a number of such sales of late within the Perth metropolitan area. All were hotly contested and attracted offers between 5.00% and 6.25%. Interestingly, the yield differential between Coles or Woolworths anchored centres and those anchored by IGA or Metcash (or even Aldi) remains pronounced and in the order of 0.75% to 1.25%.

Despite the conditions described above, institutional owned major regional and sub-regional shopping centres within Western Australia have pushed ahead with expansions following the removal of the cap on maximum retail floor space and the state government's push to create activity centres.

These expansion projects will have a focus on delivering a better retail experience for shoppers with the creation of food hubs, entertainment options (such as cinemas), health care and in some cases, residential apartments. As a result, some envisage these centres becoming community centres as opposed to traditional shopping centres in the future.

In summary, Herron Todd White sees the existing malaise in retail market conditions continuing at least in the short term as rental values remain under increased pressure and vacancy levels and tenant delinquency persist.

Opportunity does exist for investors with an increased risk appetite to acquire some of the less sought-after assets in the market place at yield premiums, or assets which would benefit from repositioning or capital expenditure.

Australian Capital Territory

Canberra

The Canberra retail property market has been steady for a number of years now. There has been strong retail interest in the CBD and suburban centres particularly in the City, Kingston foreshore and Braddon. Secondary locations and older stock have seen low levels of interest and we expect this to continue.

With the Gungahlin to City light rail now complete and a number of mixed-use developments in the works along Northbourne Avenue, there will be an increase in the amount of ground floor retail space available in the region.

We have seen a steady increase in the costs of owning commercial property in Canberra, particularly increases in territory rates. To offset these increases, we have seen more investors negotiating for net leases and increases in recoverable outgoings.

Canberra's retail turnover grew by 4.1 percent year on year to December 2019 compared to 2.7 percent year on year nationally. We have seen an increase in the number of restaurants and cafés in the CBD and suburban centres. The food retailing and café and restaurant industries make up over half the retail turnover in the region and the strong growth in these industries has seen the ACT at the top of the retail trade growth list in December (ABS - Retail Trade – December 2019).

The outlook for 2020 is for the retail property market to remain steady however any increase in interest rates or decrease in market sentiment may have a negative impact on prices in the region.

To offset these increases, we have seen more investors negotiating for net leases and increases in recoverable outgoings.