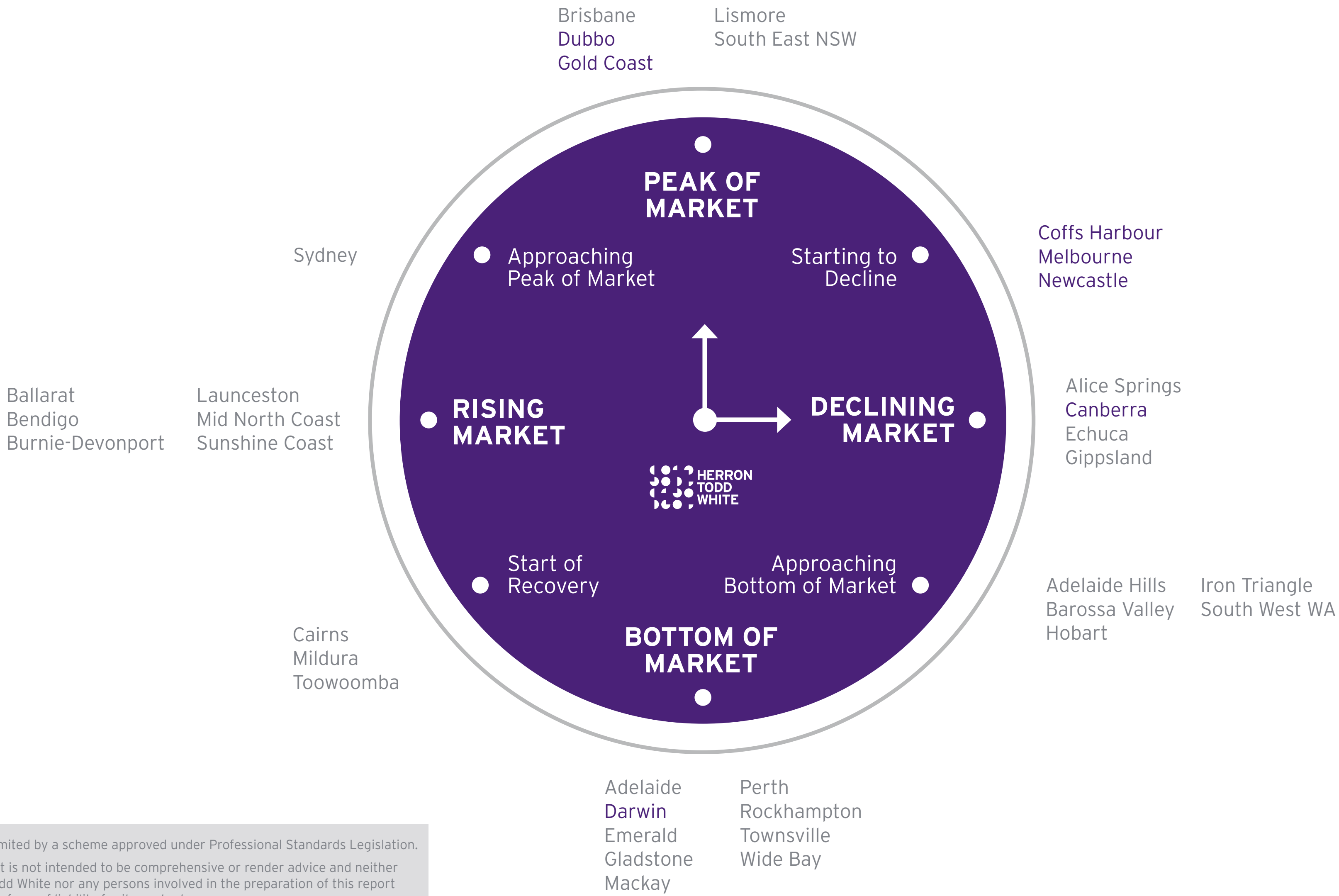
HERRON TODD WHITE COMMERCIAL

Commercial

February 2019

National Property Clock: Retail

Entries coloured purple indicate positional change from last month.



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New South Wales

Overview

Australia's retail property sector has had a fairly bumpy ride in recent years and its seems to be the case that existing businesses must adapt to survive. There are, however, pockets of promise.

This month, we give our expectation of how the retail property sector will play out in 2019 across all our service areas.

Sydney

The retail market in Sydney has seen substantial growth over the past twelve months as a result of increased demand for good investment assets, growth in rental income and generally lower vacancy rates, despite the continued threat of online shopping and generally negative perception of the retail market.

The next twelve months look to see continued interest in retail but with less demand than in 2018. Demand from investors will continue to drive the market. Properties with well-established retail tenants and those with underlying future development potential will continue to be popular this year.

The Sydney CBD remains strong, as infrastructure improvements and new development continue and speculation about the impact of these continues to drive areas of the market. Record rates for retail have been seen in the past six months in the CBD, with no evidence to suggest that this has slowed down as yet.

Within the CBD we have seen an increase in high-end retail tenants with evidence suggesting there has been some rental growth in prime locations. High-end retailers are currently looking to secure prime locations in order to meet the growing demand for luxury goods, mainly from overseas tourists. This trend is likely to continue in 2019 albeit at a slightly more subdued rate.

Generally speaking, retail rents across most areas of Sydney look likely to remain stable this year. Food and beverage outlets remain popular as do properties with an established retail trade. Evidence also suggests that some areas that include new retail opportunities (such as Green Square) may do well over the next twelve months as retailers try to secure a position in these new developments that predominantly service the surrounding residential units.

Suburban retail assets with good lease covenants have also seen growth over the past twelve months, which is likely to continue as investors look for strong performing assets, particularly if they offer some form of future growth potential or multiple income streams. That said, properties that lack exposure, have difficulty maintaining a good tenant or are in areas of oversupply of retail should be avoided by investors as usually these assets will be the first to experience a decline in value should the market soften.

Looking ahead, the outlook for retail in Sydney overall remains cautiously positive for 2019.

Looking ahead, the outlook for retail in Sydney overall remains cautiously positive for 2019. We expect prime locations to continue to perform well along with properties perceived to have growth or redevelopment opportunities in the future and properties with good returns and long lease expiry profiles. That said, we are of the opinion that the market looks to be reaching the peak of the cycle and any tightening of monetary policy or increase in the cost of debt will result in the prevailing investment yields not being sustainable.

Newcastle

We have a mixed bag of market factors playing out in the Newcastle retail space at present. This is particularly true in the hospitality sector where recent infrastructure upgrades have benefited some retail locations in the Newcastle CBD while these same infrastructure changes have rendered many retail locations untenable for some tenants.

An example of the negative impact of the new light rail line is between the intersections of Worth Place and Merewether Street on Hunter Street. Kerbside car parking to the northern elevation of this section of Hunter Street has been removed to make way for the light rail line. The "walk in off the street" retailers along this strip have found retailing to be extremely difficult and this locality will most likely morph into ground level office space before too long given the access difficulties. Proximity to the university campus will play a part in the tenancy mix here though and we will see retailers tailoring their offerings to students in this area.

On the flip side, food retailers and bars at the northern end of Darby Street and around Crown Street should benefit from the light rail stop in close proximity and we note that internal fitout construction is underway for a number of outlets in this area where office property once stood.

Sales activity in the retail sector slowed significantly over the past six months. Of the sales we have seen, selling periods have increased and yields have now begun to soften for assets of a multi-tenanted nature or those that might indicate a higher than average cash flow risk. We do note that well-tenanted property continues to sell at record low yields and of the sales we have seen, yields remain historically very low.

We anticipate a relatively slow start to 2019 as the market adjusts to new, tighter lender criteria. Some market adjustment has already been noted and while we expect some further adjustment, strong local economic factors indicate that any market value losses should be relatively limited.

Lismore

We are entering a period of uncertainty in our markets. Despite significant media attention about declining capital city markets, our coastal markets have remained relatively buoyant, albeit with softer demand.

The limited supply has contributed to this stability.

While supply conditions remain limited, we envisage the market will remain relatively stable, however if supply increases in the current weaker demand conditions, it's likely to result in a softening of the market with slightly higher yields and lower value levels over the coming months.

We note that lenders have tightened their lending policies in part due to their concerns about the market and in part as a reaction to the banking enquiry. This has reduced the number of potential purchasers and therefore has contributed to the fall in demand.

It is likely that as time passes, supply will increase as weaker demand creates slightly longer sales periods and therefore supply increases over time.

We envisage that until the banking enquiry is complete, tighter guidelines will remain in place. The completion of the banking enquiry is likely to provide a release valve as lenders will be able to adjust their policies to meet the inevitable change in lending requirements.

The broader economy does not appear to warrant the doom and gloom being portrayed by the media and as such with more balanced lending policies, a more stabilised market is likely.

Therefore, while there is a risk of decline should supply significantly increase, the market in coastal localities is likely to remain relatively stable over the coming twelve months.

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

There are significant variations in demand, yield and resultant value between prime and secondary properties. Quality investment properties with strong lease covenants (in particular long-term national tenants) are indicating reasonable to strong demand in non-coastal locations despite the broader markets being more subdued.

The recent sale of prime properties continues to indicate yields at relatively low levels. In contrast, demand and yields for secondary properties in fringe locations which have any negative characteristics or inferior tenant profiles have remained at higher levels, with analysed yields in the order of two to three per cent higher for similar non-leased product.

The exception to this rule is vacant lower priced properties which appeal to owner-occupiers and 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 rapid softening in the market which could result in downward pressure on values to coastal and non-coastal markets.

Overall, it's steady as she goes, however there is underlying risk and uncertainty which is more negative than positive.

Coffs Harbour

The retail market within the Coffs Harbour CBD is relatively stable although there is a high number of shop vacancies and rent price sensitivity. The forecast is for a continuation of this.

Retail development in Coffs Harbour City Centre is limited with an ongoing oversupply within the CBD strip centre. The Coffs Central development is now complete but not fully leased. The immediate future should see a continuation of soft conditions within the retail lease market.

There have been some strong sales for redevelopment within the Jetty precinct. Jetty Village recently sold and an adjoining development site has also sold to the same purchaser. The precinct will undergo a modern transformation in the medium to long term future.

The tightening lending policy by banks is restricting access to funds and therefore having some negative effect on the depth of potential purchasers in the local market. Purchasers remain active for strongly leased commercial property subject to the strength of the tenant and lease covenants. The strength of the local blueberry industry over the past two to three years is generating demand for commercial real estate from cashed up horticulturalists seeking medium term investment at interest rates in excess of those on offer from term deposits.

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Wollongong

Our crystal ball is telling us that the strip retail market will continue to be the weakest of the main commercial asset classes in 2019 as the industry continues to feel the effects of changing conditions surrounding online retailing and consumer spending habits.

Additionally, with negative headlines surrounding declining house prices, there is a good chance that consumers will tighten their purse strings, further impacting retailers, particularly those reliant on discretionary spending. Ultimately, this will lead to store closures.

While strip retailing will continue to experience soft conditions, we feel that strong demand will remain in the bulky goods space although the yield cycle has almost certainly reached its low point. A long-term strategy, strong lease covenants and identifying value add opportunities will be key for investors in 2019.

The local market will continue to evolve and retailers will do their best to adapt to their trading environment. The rejuvenation of the Wollongong CBD will advance as the city's population base grows and we will see more of the traditional retailers being replaced by those in the food and beverage sector. Rents will remain flat and smaller shop fronts in the range of 50 to 100 square metres will be in most demand. Incentives required to lease vacant space and extended letting up periods will remain common in some locations.

Dubbo

Forecasting market movements is always difficult given the number of variables influencing the actions of market participants.

Overall, as elsewhere, consumer sentiment, cost of living pressures, housing construction, credit availability, online sales and potential movements in interest rates impact consumer spending and therefore demand for bricks and mortar retail space.

However in the Dubbo area, another factor influencing the retail property market is the continuing drought.

While the Dubbo economy as a whole is relatively resilient, with a depth and exposure to both government and a diverse range of private enterprise sectors, the Dubbo retail sector relies on western and north-western regional New South Wales consumers for continued healthy cash flows. Drought in these areas does impact negatively on both the local areas and Dubbo. In the event that the current drought extends for a significant time into 2019, then Dubbo, being the major service centre to the region, could see downward pressure on shop revenues which would impact negatively on enquiry and demand for retail space. Further, agricultural business owners often invest surplus funds in off-farm commercial property in regional centres such as Dubbo, and their absence reduces the pool of potential investors.

6.62% - 7.00%

analysed yields for retail property in Dubbo

In the calendar years 2017 and 2018, we witnessed a tightening in analysed yields for retail property in Dubbo of circa 500 basis points to a range of 6.62 to seven per cent, although on reduced sale volumes. Given the above market factors, we consider current yields to be at a market peak in Dubbo with yields in 2019 either holding or more likely softening to reflect increased risk. Rental rates, on the other hand, are reported to be stable with tenants willing to pay current rates for suitable space. However, large floor areas of more than 500 square metres are proving difficult to lease, with extended vacancy periods, sometimes in excess of twelve months.

Victoria

Melbourne

Melbourne's retail property investment market experienced many strong results throughout 2018, with firm yields reflecting the limited availability of quality stock and solid purchaser demand. Whilst demand for quality retail assets remains strong, particularly for well-located properties which have long-term leases and strong lease covenants, there is evidence that tighter commercial lending criteria is restricting access to funds for many potential purchasers.

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 seen over the past five-year period. When listed for sale, some retail properties are experiencing extended selling periods, particularly vacant retail assets and those in secondary locations.

During 2019, 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 properties which have longer term potential for redevelopment. It's likely that yields may soften for retail properties in secondary locations, particularly in areas with low tenant demand and high vacancy rates.

Chapel Street, Melbourne Source: Wikipedia

Although purchaser interest for retail properties has been relatively high, we are of the view that this is led by an optimistic buyer perception of the market direction and may not ultimately reflect what is actually happening in relation to tenant demand, affordability and achievable long-term investment returns on property. There appears to be a discrepancy between capital values and rental income growth as capital values within popular precincts appear to be experiencing strong growth, while rental income growth appears to be moderate, and in some cases declining, in comparison. As such, the market within these precincts tends to be influenced to a large extent by economic volatility.

During 2019, 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 are likely to continue to experience high levels of vacancies as a result of the ongoing shift away from traditional retailing towards service and food based uses.

Finally, the effects of the Royal Banking Commission cannot be overstated.

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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 that appeals 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.

Finally, the effects of the Royal Banking Commission cannot be overstated. We have already seen lenders putting the brakes on loans to most sectors, including the retail sector. Residential prices have fallen in many locations in Melbourne and thus people's confidence has dropped and "mums and dads" and small businesses seem to have less to spend. We have just witnessed one of the worst Christmas spending periods in recent times, due largely to the above. If these trends continue, tenants will find it more difficult to meet their occupancy costs, landlords will have to soften their rental demands and the ultimate result may be falling retail rents and capital values in the short to medium term. If interest rates rise in 2019 then downward pressure on retail rents and capital values are likely to be even greater.

South Australia

Adelaide

The Adelaide office market appears to be reaching a more positive perspective after a challenging 12 to 18-month period where incentives rose circa 30 to 40 per cent.

The growth of the defence, health and resources sectors locally has seen some major acquisitions occur, such as BAE securing 3,000 square metres at 80 Flinders Street and Lockheed Martin and Saab negotiating 1,500 and 3,000 square metre areas respectively elsewhere. Additionally, CBD office supply is to be boosted with 24,500 square metres of A-grade space coming on-line in 2019.

For smaller office tenancies under 500 square metres, it will be business as usual – static conditions overall, however fringe areas such as Greenhill Road and Fullarton Road (on the city's border) are struggling to retain tenants. These areas were previously more desirable to inner-city locations for national and international entities, however improved public transport and greater general amenities in the CBD has reversed this. Greenhill Road and Fullarton Road, whilst offering good on-site car parking, are now stuck in no man's land – positioned awkwardly between growing CBD office precincts with popular recreational areas and outer suburban locales which offer greater street parking and more affordable rents.

The retail sector performed well, generally speaking, in 2018 with retail volumes expanding 2.6%, however it's also been another year when the household savings rate has tumbled as income growth fails to keep up with spending growth. That has been fine while property prices boomed, but with prices now falling, consumers will be more constrained when it comes to spending on retail goods.

Locally, messages have been mixed. Bunnings continues to open stores with its $45 million development in Edwardstown currently at frame stage and set to open mid-2019, however German hypermarket retailer Kaufland has stalled construction on its 3.6-hectare site at fringe location Keswick (former Le Cornu site). It is rumoured locally that Kaufland has grown tired of negotiations with Unley Council and is attempting to sell the site which it purchased in October 2017.

For the retail sector to grow locally, there has to be some household income growth to free up discretionary spending.

With a federal election approaching in 2019 and a change in government likely, it is expected that market conditions will remain static until at least we know for certain who the next prime minister will be.

It is understood that Bill Shorten's election promises will revolve around abolishing negative gearing which the Labor party has indicated would likely commence around mid-2020. Whilst reforming negative gearing might make it easier for first home buyers to enter the market, it could also cause a significant drop in prices due to investors being less active. Coupled with tighter lending processes, this could have a detrimental effect on most property markets if not handled correctly.

Shorten also unveiled a $15 billion energy plan in November 2018 which proposes an emissions reduction target of 45 per cent across the economy and to have renewable energies achieve a 50 per cent market share of the electricity market by 2030.

The coalition stated that commitments to such targets will undoubtedly lead to the closure of existing businesses and massive job cuts in industries such as aluminium smelters, refineries, fertiliser factories and cement factories. This could also have a dramatic effect on commercial property markets.

In South Australia, retail sector rents and yields have remained static overall in the past twelve to 24 months, however arterial road showrooms appear to be the biggest hit with rental reductions dropping 20 to 30 per cent and almost eradicating their viability. The growth in rezoning the residential medium-density areas along arterial roads has also encouraged this drop in rental rates.

In terms of retail market opportunities, land remains relatively affordable in Adelaide compared to our eastern seaboard counterparts.

The Adelaide office market appears to be reaching a more positive perspective after a challenging 12 to 18-month period where incentives rose circa 30 to 40 per cent.

Queensland

Brisbane

The year ahead is likely to see a continuation and even acceleration of trends that are becoming well established: the continued growth of online retail; the fragmentation of retail markets; the continued struggles of sub-regional shopping centres; and stagnant or falling rentals across many sectors.

The Brisbane landscape is however continuing to expand with the recent addition of new boutique retail precincts including the recent opening of both the Howard Smith Wharves development and the first retail laneway at Sekisui's West Village development. Additionally, there is ongoing growth of the James Street precinct and the King Street precinct. These projects continue to expand Brisbane's dining and entertainment options, possibly at the expense of older precincts.

In established retail markets, the sentiment is varied.

CBD retail rents have softened over the past twelve months with an increase in incentives, particularly in secondary locations. The CBD will also face disruption challenges as works on major projects such as the Cross River Rail and the Brisbane Metro start to ramp up.

Convenience and neighbourhood centres have shown signs of strength with some evidence of moderate rent growth in strong population growth locations. Ongoing population growth in greenfield locations continues to drive the development of new centres and Coles, Woolworths and Aldi maintain active development programs to support new centres. The rental environment overall however remains flat.

West Village, West End, Brisbane

Source: sekisuihouse.com.au

YIELDS FOR RETAIL PROPERTIES

- Neighbourhood centre **5.5% to 6.5%**
- Convenience centre **6.5% to 7.5%**
- Sub- regional **6.5% to 7.25%**

Sub-regional and regional shopping centres remain under pressure, being most at risk from the growth of online retailing. The collapse of the Ed Harry chain highlights the difficult trading environment for clothing retailers in particular. This is putting downward pressure on rents and capital values.

Yields and capital values for retail properties are neutral at best. Whilst there is still strong demand for high quality retail properties, the quality of the lease covenants and sustainability of rents is now firmly in focus with investors. At the private investor end of the market, neighbourhood centre yields continue to lead the way with yields in the 5.5 to 6.5 per cent range. Convenience centre yields have flattened out and remain in the 6.5 to 7.5 per cent range. Sub-regional yields are showing signs of softening and are generally in the 6.5 to 7.25 per cent range. Overall transactional levels are low at present due to a shortage of good stock.

Development of service station sites is now slowing after a strong growth phase over the past four years. The availability of good new sites is diminishing and a number of localities are reaching market saturation. The trend towards fast food tenancies within new developments is continuing, but at a reduced pace.

There is limited opportunity in retail in the market at the present time other than in outer locations. Refurbishment of older centres remains an option, but it can be hard to achieve viability given the flat leasing markets.

For the year ahead, we foresee a mixed bag for Brisbane. Population growth will continue to sustain development of new centres in outer localities and boutique retail areas in inner city locations are likely to continue to expand. We consider however that rentals and yields are likely to remain flat across the board and may further decline in older non-growth areas and centres. Disruption from construction works are likely to impact the CBD in particular.

Gold Coast

The retail market on the Gold Coast has been holding a steady course over the past six months. As we sail into early 2019, the coast appears clear, however we are on the lookout for submerged rocks which may steer us off course.

It's no secret that the local commercial property market has experienced notable increases in activity and price levels over recent years. This strong market sentiment was largely fuelled by the prevailing low interest rate environment and availability of credit. The number of investors actively seeking retail property on the Gold Coast was on the rise and the number of quality investment properties was limited. The combined effect of these factors was a sharpening of investment yields across the board.

We are yet to witness any evidence suggesting downward pressure on capital values on the Gold Coast.

Implementation of stricter lending criteria by the major lenders, increased debt funding costs and domestic and international political uncertainty took the wind out of the sails in 2018, suggesting a more balanced market leading into 2019.

The NAB Commercial Property Index fell nine points to a two-year low in the third quarter of 2018, but is still well above long-term average levels. Retail sentiment dived into negative territory, with average survey expectations for capital growth over the next one to two years recorded at -1.4 and -1.7 per cent for the retail market. The survey result for retail rent outlooks has also weakened further and is expected to fall in all states.

Notwithstanding the above, we are yet to witness any evidence suggesting downward pressure on capital values on the Gold Coast. There remains a lack of retail investment stock being taken to the market which is keeping supply and demand metrics in check. Selling agents report that buyers are becoming more discerning and less rushed in their purchase decisions, however are still present and active in the marketplace.

11.1%

spike in visitor spending, from last financial year, with a **$1.3 billion** benefit to the Gold Coast

From a valuation perspective, the biggest risk we foresee is rent sustainability. With a relatively large influx of retail accommodation across the Gold Coast over the past few years and only so many consumer dollars on offer, there will unfortunately be some retailers who will not see it through. This is expected to fuel a continuing or even strengthening preference for properties anchored by national retailers.

Fortunately, international visitors are still flocking to our beautiful beachside city, which will continue to support the retail market along the beachside suburbs. Official results from last financial year show an 11.1 per cent spike in visitor spending, with a $1.3 billion benefit to the Gold Coast. Visitor spending on the Gold Coast was notably higher than that of Queensland and more than double the Australian growth of 4.83 per cent according to www.mygc.com.au.

Toowoomba

2018 saw a high level of activity in the Toowoomba retail market with completion of QIC's Grand Central Shopping Centre redevelopment and a number of smaller retail developments, including:

- **The Intersection** located on the corner of Ruthven and Alderley Streets in Kearneys Spring with a mix of tenants, including Subway, Café 63, Oporto, Burger Urge and Baskin-Robbins. The Subway and Café 63 tenancies provide drive-through facilities.
- **Coles Express** located on the corner of Ruthven and Alderley Streets in Kearneys Spring. This project included the redevelopment of a Shell service station and two food tenancies. The larger tenancy has a drive-through facility and is leased to Pump Café.

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Eastside Village, Toowoomba Source: eastvilletoowoomba.com.au

- **Eastside Village** is located on the corner of Herries and Cohoe Streets in East Toowoomba. The centre is anchored by McDonald's and KFC with other tenants including Café 63, Bel Cibo Italian and the Burrito Bar.

This trend is expected to continue in 2019 with a number of retail developments in various stages of the development process. These include:

- **A new car wash in James Street** on the CBD fringe. The car wash uses the latest automatic drive-through wash tunnel and will include a small café tenancy and a digital sign board.
- **Several developments on Anzac Avenue** in the suburb of Harristown. These include two food based centres in close proximity to each other anchored by national café tenancies with drive-through facilities and a child care centre currently nearing completion.
- **Development of the Gladstone Hotel** into a five-storey accommodation and lifestyle facility with 104 motel rooms, retail shopfronts and a beer garden at a cost of $20 million. Demolition has been completed, development approval issued and construction is due to commence early in 2019.
- **Continued development of the Walton Stores** project with the popular Mexican chain Zambero recently announcing plans to open an outlet in the complex during 2019.
- **Redevelopment of the 103-year-old Longs Quarter** building in the Toowoomba CBD due for completion in early 2019. The redevelopment will include a mix of retail and office tenancies, with commitments from a café and legal firm in place.
- **A $20 million refurbishment of the Wilsonton Shopping Centre** following its sale for $50 million during 2018.

While the above suggests a high level of leasing activity for the Toowoomba retail sector, competition for tenants is likely to require increased use of incentives to attract tenants into the new floorspaces. This is expected to have a negative effect on older premises, particularly in the CBD. The end result should see rentals remain stable throughout 2019 with a slight uplift in vacancy rates for older, dated premises. A long-term CBD furniture retailer, Amart Furniture, has recently relocated to a suburban bulky goods complex, the former Masters Home Improvement site redeveloped by Home Consortium, creating a large vacant CBD floorspace with no redevelopment plans announced at the time of writing.

The low interest rates should result in continued high investor demand for retail properties with strong lease profiles, however the lack of supply of quality, fully leased properties will limit the number of investment sales with net yields expected to remain firm.

Townsville

As we head into 2019, the year ahead for the retail sector is likely to remain at status quo with interest underpinned by national investors for property offering strong investment returns with long term leases or national tenants, whilst activity from local buyers and within secondary stock is likely to remain flat.

There is positive sentiment in the market on the back of major projects underway including the

North Queensland Stadium, Haughton Pipeline duplication and the port channel widening along with recently announced projects including the $300 million Sun Metal zinc refinery expansion and improving confidence in the mining sector, however to date the reaction of the market to these developments has been relatively subdued, although is gaining traction, albeit at a very slow pace.

Fairfield Shopping Centre is currently undergoing its Stage 3 expansion at a reported cost of $32 million, which will be anchored by a Coles supermarket and is expected to be completed during 2019. Other proposed retail projects heading into 2019 include a new retail shopping centre proposed to be constructed in Rasmussen to be built over two stages.

Over the coming year, we are likely to see national investors remain interested in the market given the attractive yield spread in regional areas relative to their home locations. The leasing market is likely to continue to demonstrate high levels of leasing incentives as there remains an oversupply of retail space available relative to current levels of demand with online shopping continuing to place pressure on mainstream retail.

Sunshine Coast

Throughout 2018, the retail market on the Sunshine Coast generally reflected the overall retail markets of greater south-east Queensland. We have seen strong yield compression for national tenant holdings appealing to a larger regional style market over the past three years.

Retail confidence will continue to strengthen within the Sunshine Coast, reflected in developments such as the ongoing Sunshine Plaza redevelopment, the new Stockland Birtinya shopping centre and the extension and refurbishment of Kawana Shopping World.

The $400 million redevelopment of Sunshine Plaza will see the centre expand from 73,000 square metres to over 107,000 square meters, making it the largest retail centre north of Brisbane. Source: sunshineplaza.com

The $400 million redevelopment of Sunshine Plaza will see the centre expand from 73,000 square metres to over 107,000 square metres, making it the largest retail centre north of Brisbane. The centre will comprise new national and international tenants including David Jones department store, Big W, H&M and over 100 new specialty stores. The first stage included the refurbishment of the existing Myer department store and 40 speciality stores which opened in late 2018. The remainder is scheduled to be completed prior to Easter 2019.

Stockland Birtinya comprises a new 10,348 square metre shopping centre which commenced trade in the first week of 2019. The centre is located in close proximity to the Sunshine Coast University Hospital and Stockland's residential communities of Oceanside and Bokarina Beach. The centre comprises Coles, Aldi and 40 speciality stores with fresh food and experience-driven retailing being the main focus.

Kawana Shopping World's retail and carpark expansion was completed in late 2018 with the addition of a ten-screen cinema operated by Event Cinemas, a new restaurant precinct as well as extensive renovations to the existing centre and increased car parking.

These expansions to the shopping centre offering on the Sunshine Coast have been driven by population growth to the area from both local and interstate occupants, with a forecast of circa 2.5% annual growth or an increase of 8,300 people per year. Tourism has also seen a steady increase throughout the region over the past three years from both Australian and overseas visitors.

Tourist centres such as Hastings Street and the general Noosa region, Maroochydore and Coolum Beach are experiencing limited vacancies, with Mooloolaba still struggling with rental affordability for local retailing tenants and uncertainty surrounding proposed developments. These trends are likely to continue through 2019.

2.5%

forecast of annual growth or an increase of **8,300 people** per year to the Sunshine Coast

Secondary and service township retails strips have also improved and are likely to continue to improve during 2019. Areas such as Montville, Maleny, Eumundi and Palmwoods have seen a drop in overall vacancy levels over the past twelve to 24 months.

The Bulcock Street, Caloundra streetscape works are in the final stage and are due for completion in 2019. The streetscape works were undertaken by the Sunshine Coast Council, with the view to enhancing the look and experience of the area, improving safety and increasing foot traffic. The works undertaken have affected some retail trade along the strip which is still seeing higher overall vacancy rates than other similar areas.

Low interest rates coupled with a weak exchange rate have encouraged increased interstate and local travel which has seen the tourism localities benefit over the past twelve to 24 months. Any changes in the economy could have a greater effect on these tourism-driven areas moving forward. Due to this, local retailing strips that service larger residential localities are seen as less volatile, with the focus on refurbishment of these centres and increasing the fresh food offering.

The Sunshine Coast has seen strong yield compression over the past twelve to 24 months and moving forward into 2019, we anticipate a more stable market with yields stabilising.

Rockhampton

2019 is likely to continue at much the same pace as 2018 in the retail sector, however we are hopeful that new projects on the horizon and a general increase in market sentiment will have a positive flow on effect later in the year.

There are infrastructure and defence projects in the region that have either commenced or are in the pipeline that will be creating employment opportunities for locals and increasing market confidence. These are projects such as Clarke Creek wind farm, Rookwood Weir, Defence projects at Shoalwater Bay, Main Roads projects and upgrades to the Capricornia Correctional Centre to name a few. Some projects are still awaiting the green light, however are increasing optimism in the market.

Retail developments planned for the year include the completion of the Aldi supermarket (after a recent announcement that the project is back on

Former Bunnings site on Yaamba Road sold for $9.9M and it will be a site to watch over the next 12 months. Source: .commercialrealestate.com.au

track with a new contractor) and redevelopment of the ex-Masonic Club on William Street. This site was purchased in 2018 by a local developer and it was recently reported that the development will involve renovation of the existing improvements to a cafe / restaurant and accommodation.

The former Bunnings site on Yaamba Road sold late last year and it will be a site to watch over the next twelve months. The property was purchased for $9.9 million and comprises a substantial area of vacant retail warehouse accommodation. Plans for the site are as yet unknown to us.

As retail market conditions are still considered to be relatively flat, we do not anticipate any substantial rental growth, as rental affordability is still key for retail tenants. There are still substantial vacancies within secondary retail centres and centres where asking rentals are too high and until the vacancies tighten there is unlikely to be any significant growth.

Gladstone

The retail market in Gladstone definitely took a blow with the announcement of the closure of the Target Country late last year. Despite this, there has been some recent commentary in the press that the retail outlook for 2019 is positive, which is a nice change on the back of the declining market in recent years for the Gladstone property market.

Whilst we do not forecast any substantial changes to the retail market, we are hopeful that the improvements we are seeing in the residential market will have a flow on effect in the retail market, with improved sentiment and some renewed confidence. There are still some substantial vacancies within retail shopping centres and it will take some time for these to be absorbed. As a result, we do not anticipate that there will be any notable rental growth, as rental affordability is still key for local businesses. Additionally, incentives are also likely to play a role in new retail lease negotiations until such time as vacancies begin to tighten and supply reduces.

Wide Bay

The retail sector within the Wide Bay has demonstrated a consistent trend over the past few years in terms of rental levels, yields and vacancies. The sector has continued to attract interstate investors with relatively high yields compared to major southern localities.

Bundaberg

The Bundaberg retail sector can be divided into three main precincts, being the Central Business District (CBD), Kensington bulky goods precinct and the sub-regional shopping centres.

The Bundaberg CBD is a relatively vibrant CBD compared to other major regional localities across Queensland. A recent significant sale in the CBD is of the building formerly occupied by Best and Less, purchased for $3 million by a national pharmacy business intending to owner-occupy the property. Vacancies within the Bundaberg CBD are relatively low, particularly within the CBD's heart along Bourbong Street, between Barolin Street and Targo Street. In 2019, we would anticipate a consistent year for the Bundaberg CBD.

$170 to $200

per sqm gross rents for modern retail buildings in Bundaberg

The Kensington Park Estate has established itself as a prominent location for bulky goods retail within Bundaberg with a number of large retail brands situated within the precinct. We have seen a reasonable level of demand from national retailers to be located within this precinct, with a new complex set to host Fantastic Furniture currently under construction and scheduled to finish early in 2019.

Investor demand for modern retail buildings with nationally branded tenants on long term leases remains strong, with yields for properties of this calibre remaining quite low in the order of 7.25 to 7.75 per cent. We would expect retail yields for properties with these attributes to remain low over the short term, however would be susceptible to an increase should interest rates rise. Gross rents within this precinct typically fall between $170 and $200 per square metre depending on the size and quality of the tenancy.

The retail sector in Bundaberg is also heavily dominated by the two sub-regional shopping centres (Stockland Bundaberg and Hinkler Central). Vacancies within these centres appear to be relatively low, with both centres attracting new retailers throughout 2018. These centres are expected to maintain their heavy dominance of the local retail sector over the foreseeable future.

Hervey Bay

To some extent, Hervey Bay has a less distinguishable retail sector. The main retail locality is around the Stockland Hervey Bay shopping centre fronting Boat Harbour Drive, extending north along Main Street in Pialba. Other retail locations are scattered throughout Hervey Bay and include a number of smaller neighbourhood shopping centres.

Retail vacancies within Hervey Bay have proven to be somewhat stubborn, however are slowly decreasing. Rental rates can vary quite significantly depending on the location, size and quality of the tenancy. In general terms, retail yields can sit between 7.5 per cent for a modern building with a good quality tenant on a long-term lease to nine per cent for a lower quality or older building with a lesser quality tenant with low quality lease covenants.

Our forecast for the Hervey Bay retail sector in 2019 is a low rate of sale and limited gross rental growth potential. The higher local yields being achieved may attract some interstate investors.

Maryborough

The retail sector in Maryborough is heavily dominated by the sub-regional shopping centre, Station Square. Other prominent retail locations in Maryborough appear to surround Station Square shopping centre along Alice Street and within the Maryborough CBD along Adelaide Street.

Vacancies within the Maryborough CBD remain relatively high, however, the recent sale of 179 Adelaide Street at $1.45 million (circa 8.5 per cent yield) indicate that there is some demand for retail properties that are well located and occupied by a nationally branded tenant. Generally, gross rental levels sit between $170 and $200 per square metre within the Maryborough CBD.

Our forecast for the 2019 retail sector in Maryborough is a relatively low rate of sale and limited gross rental growth potential. The higher local yields being achieved may attract some interstate investors.

Mackay

We believe there has been a positive change in market sentiment in the retail property sector in Mackay due to ongoing economic recovery, extensive government infrastructure works, increased employment and, as a consequence, local population growth.

In recent months, large bulky goods tenancies which were vacant for years through the economic downturn are now leased. A notable example is the former Sam's Warehouse tenancy in Greenfields retail precinct at Mount Pleasant, where a 742 square metre section was leased to Ambiance Indoor Outdoor Furniture in September and a 1,675 square metre tenancy was leased to Silly Solly's discount warehouse in October last year.

Rental rates are approximately 25 per cent lower than the 2012 peak and appear affordable enough to allow tenants to successfully trade as the economic recovery continues and retail activity improves.

There has been limited retail leasing activity and limited enquiry around the city centre. The Dome Arcade in Victoria Street, originally established as a retail complex, had several tenancies available for lease which have now been partially let to medical

This has been the most active period of commercial sales activity in Mackay for many years.

and other service-based tenants. Enquiry from retail tenants has been slow. Similarly, a large tenancy on the ground floor of the former Suncorp Building in Victoria which was advertised for retail use has been leased to a community service provider.

There is very little to report in terms of retail sales activity. We believe that there would be strong demand for well anchored shopping centres and neighbourhood shopping centres if any such investments were available for sale in the Mackay region.

Moving off topic from the retail sector, we could not let this edition of the Month in Review go past without commenting on the large number of commercial properties which have sold in Mackay city since September last year.

These are summarised as follows:

- **11 Peel Street** - The former McGinns Hardware property sold at $2.85 million in September.
- **105 - 109 Victoria Street** - The former Centrepoint Shopping Centre which has been substantially converted to a nightclub complex was sold by receivers at $3 million in September.
- **74 Wood Street** - Mackay Central (Coffee Club and Coco Cubano) was sold by receivers at auction under the hammer for $2.65 million in December 2018.
- **22-30 Wood Street** - A large, modern, double-storey office building leased to State Government tenants reportedly sold at $3.5 million in December 2018.
- **8 - 10 Sydney Street and 21 Sydney Street** - The Mackay Spare Parts building is reported to be under unconditional contract dated November 2018 at an undisclosed price and awaiting settlement. This is another receivers sale.
- **Corner Sydney Street and Victoria Street** - The Palace Hotel is reported to be under contract at an undisclosed price.

74 Wood Street, Mackay Central Source: ealcommercial.com.au

This has been the most active period of commercial sales activity in Mackay for many years. These transactions indicate that the time is right to take advantage of the low point in the market cycle. With commercial listings now being readily absorbed and several receivership sales now completed, we believe that commercial value levels have now reached a cyclical low point and should begin to follow the moderate increase in values which have been observed in the Mackay residential market over the past twelve months.

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Northern Territory

Darwin and Alice Springs

The calendar year 2019 promises to be challenging for all property markets across the Northern Territory and especially in Darwin. The release of an interim report into the NT Government's finances has found that on current expenditure trends, the Territory's net debt will increase from $3 billion to $35.7 billion by 2030. This is partly attributable to a decline in the Territory's GST revenue share by $500 million per annum. The NT Government will need to make some tough expenditure decisions and this will have an impact on all aspects of the economy, including the property sector.

The retail sector in Darwin is already experiencing difficult times due to population decline. A number of well-established local businesses have closed over the past twelve months and unless trading conditions improve, it is inevitable that others will join them. The recent closure of Darwin's CBD cinema complex is symptomatic of retail economic conditions, especially in the CBD.

The NT Government is intent on pushing ahead with its Derelict and Vacant Property Levy which will be introduced in July 2019. This levy will be applied to CBD property which is vacant land or has a building vacancy in excess of 50 per cent. The aim of this levy is to encourage owners to activate their properties to create a more vibrant CBD.

Darwin cruise terminal complex Source: www.cruisemapper.com

On a more positive note, the cruise ship season for Darwin is in full swing, with 19 arrivals scheduled for the first quarter of 2019. These visitors do swell the numbers in the Mall when a ship is in, creating retail opportunities for local traders.

$35.7 BILLION

The Territory's net debt will increase to by 2030

Although the current economic environment is weak, it does open up opportunities to investors. We are aware of a significant modern retail investment property in Alice Springs with a good lease profile which has recently sold for a yield in excess of 9.5 per cent.

The NT Government will need to make some tough expenditure decisions and this will have an impact on all aspects of the economy, including the property sector.

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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 with the announcement of a raft of new projects, confidence in general remains depressed.

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

Our team continues to field enquiries from tenants struggling to meet rental payments by virtue of 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 (Oxford Street, Leederville; Beaufort Street, Mount Lawley; and Bay View Terrace, Claremont) are now beginning to experience a similar situation with vacancies beginning to appear and not being as readily leased as perhaps twelve to 24 months ago.

Investment grade retail property (neighbourhood shopping centres for example) remains a highly sought-after asset. Yield compression is evident,

Westfield Carousel Source: Wikipedia

largely driven by the low prevailing cost of funds in the current debt finance market and despite the general malaise impacting the wider Western Australian economy including softening rentals and an increasing number of business failures and receiverships.

However, there are a certain number of key metrics that informed investors are considering relating to length of remaining lease term (i.e. WALE), financial strength of the tenants 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 which do not possess these key criteria are however less sought after and often transact at a much higher yield reflecting the greater tenancy risk.

In defiance of the above however, sites in the aforementioned high street locations remain keenly sought after despite the level of tenancy risk, which 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 per cent are not uncommon.

In respect to investment grade retail transactions, there were a number of such sales throughout 2018 within the Perth metropolitan area with all were hotly contested, attracting offers between five and 6.25 per cent. 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 per cent.

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

Expansions of Westfield Carousel, Garden City, Karrinyup, Westfield Innaloo, Midland Gate

Our team continue to field inquiries from tenants struggling to meet rental payments by virtue of lease agreements negotiated in more buoyant times.

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and Ellenbrook Central are either underway or proposed in the short to medium term.

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 that these centres will become community centres as opposed to traditional shopping centres.

It is also worth noting the success associated with the opening of the DFO within the Perth Airport grounds in October 2018 which to date has been very popular with consumers largely due to the discount spending offered by retailers. The centre, which comprises 113 retailers, opened fully leased and provides retail shoppers with a full experience including dining precinct, children's playground and extensive parking (albeit paid). It will be interesting to see if its popularity can be maintained in the short term.

In summary, Herron Todd White sees the existing malaise in retail market conditions continuing in at least the short term as rental values come under increased pressure and vacancy levels and tenant delinquency increase. Opportunity does however exist for investors with an increased risk appetite to acquire some of those 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

In 2019, the Canberra retail market will witness both the completion of new and the reinvigoration of existing retail precincts. Retail sale statistics issued in November by the ABS indicate growth of 1.6 per cent (above the national average) in seasonally adjusted terms for the nation's capital. The trend is positive overall and can be in part attributed to generally strong employment, improved consumer confidence and consistent population growth (2.2 per cent).

The Braddon retail district is now well and truly established, with only a handful of newly completed ground floor units remaining available. The expansion of the Fyshwick Fresh Food Markets (known as the Niche Markets) has been received well, adding 40 retail tenants into the complex.

Notable major additions to the market in 2019 include the completion of Kambri located at the Australian National University. This brings 45 additional retail tenants to the area, with only ten per cent remaining un-leased ahead of the February 2019 opening. Another precinct which will be delivered in 2019 is DKSN in Dickson. The first stage of DKSN will serve as a mixed-use precinct bringing 300 apartments, pre-committed government office space and 40 retail and hospitality units to the market.

With the first stage of the Canberra light rail moving towards completion, we have seen an increase in interest in retail offerings in close proximity to the rail stops. Areas such as Flemington Road, which in the past have experienced higher vacancy levels for both residential and commercial space, have begun to strengthen and will continue to do so after the completion of stage one.

Fyshwick Fresh Food Markets Source: stewartarchitecture.com.au

The only downside we see on the immediate horizon is the follow-on effect on existing retail stock from the introduction of the aforementioned retail precincts. Demand for non-central, ageing stock, especially those in smaller local shopping centres that have already struggled with declining patronage, will likely see a rise in vacancy throughout 2019.