Australian Retail Review

Knight Frank

September 2024

Trading performance has been resilient and with household spending set to improve, the conditions are in place for growth in 2025 and beyond

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Key insights

After a challenging period, the outlook for the retail sector is increasingly positive with real incomes returning to growth, turnover and leasing spreads in the major centres on an upward trajectory and investor sentiment improving as macro headwinds ease.

BEN BURSTON
CHIEF ECONOMIST, RESEARCH & CONSULTING

4.1%

Strong wage growth

A tight labour market has pushed up wage growth to 4.1% y/y, helping to offset the impact of inflation and generate a return to real income growth.

3.0%

Forecast retail sales growth

After challenging conditions in 2023 and H1 2024, retail sales growth has picked up in recent months and the outlook is improving.

5.2%

Average MAT growth

Across the top 20 shopping centres, MAT growth averaged 5.2% in 2023.

300bp

Retailer EBIT improvement

Despite significant headwinds, major retailers reported higher profit margins in 2023.

$5.1 bn

Investment volumes H1 24

After a period of limited liquidity, deal flow is starting to pick up with $5.1 billion traded in H1 2024.

41%

Private capital most active

Private investors have been most active, accounting for 41% of total acquisitions in 2023-24.

Key indicators

State	Retail sales growth (values, y/y)	Forecast growth 2025 (values)	Unemployment rate	Wage growth (y/y)	Population growth (y/y)
VIC	2.8	3.2	4.5	3.3	2.2
NSW	2.2	1.8	4.0	4.2	2.8
QLD	3.7	4.4	4.2	4.6	2.6
WA	4.3	3.4	3.7	4.2	3.3
SA	2.0	2.6	4.2	3.9	1.6
TAS	3.0	1.8	4.1	5.1	0.4
Australia	2.9	3.0	4.2	4.1	2.5

Source: Knight Frank Research, ABS, Oxford Economics

Economic overview

Pressures on the consumer starting to ease

INFLATION EASING, ALBEIT NOT IN A STRAIGHT LINE

Over the past two years, a combination of pressures on the consumer have proven a challenging backdrop for retail spending. High inflation has out-stripped growth in wages, resulting in declining real incomes, whilst rising interest rates have cut into household budgets even further.

However, after a long wait, relief appears close at hand. Firstly, inflationary pressures are easing, albeit more slowly than financial markets and policy makers would like. Globally, headline CPI has fallen to around 3% in the United States and 2.5% in Europe, prompting the commencement of interest rate cuts from several central banks. In Australia, the decline has been slower, with headline CPI standing at 3.8% at end Q2. However, over the next 12 months a further decline is all but assured off the back of legislated energy bill relief and a slowing in the pace of growth in key items squeezing household budgets like rents and insurance costs.

TIGHT LABOUR MARKET DRIVING WAGE GROWTH

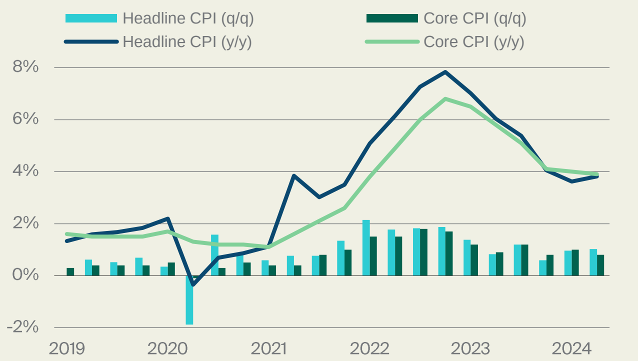
At the same time, ongoing wage growth will start to support consumers more meaningfully as it starts to exceed the pace of inflation, translating into growth in real incomes. The labour market remains tight, and wage growth has jumped to 4.1% annually according to the WPI measure, the highest rate of growth since 2009. While the pace of wage growth may moderate from here, legislated increases in minimum wages and persistent staff shortages in several industries will continue to result in solid income growth.

REAL INCOME NOW RETURNING TO GROWTH

The combination of solid wage growth and declining inflation has shifted real income growth back into positive territory, and further improvements are expected in 2025 and 2026. In addition to this, tax cuts and a raft of cost-of-living measures from State and Federal governments will also aid the consumer and bolster disposable income, while strong population growth will also play a part in boosting aggregate spending capacity.

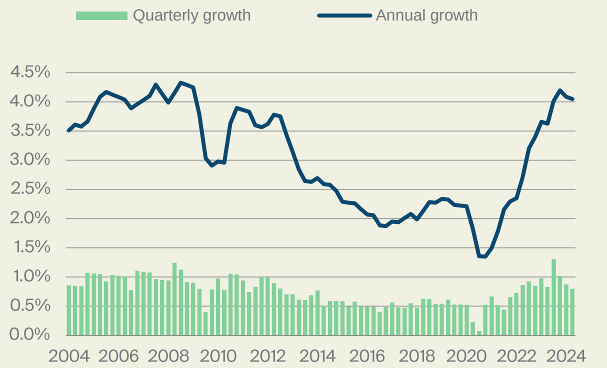
As a result, after real disposable incomes declined by 2.5% in 2023, Oxford Economics forecasts a strong resurgence with growth of 2.1% in 2025 and 4.2% in 2026. This will lead to a gradual improvement in consumer spending and enable economic growth more broadly to accelerate, providing a more supportive environment for retailers in 2025.

CPI - headline and core measures
Annual and quarterly growth (%)



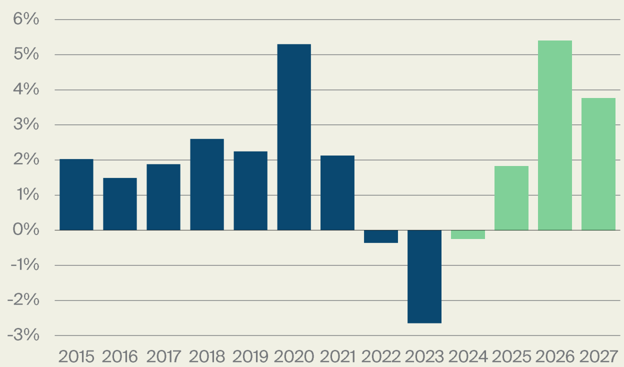
Source: Knight Frank Research, ABS

Fastest wage growth since 2009



Source: Knight Frank Research, ABS

Return to real income growth
Total household real disposable income growth



Source: Knight Frank Research, Oxford Economics

Retail sales trends

Lack of momentum in H1, but sales outlook improving

SIGNS OF A PICK-UP IN SALES IN RECENT MONTHS AFTER A SLOW YEAR

Given the contraction in real incomes and the pressure of higher interest rates, retail sales momentum has inevitably been slow over the past 12 months. In nominal terms, sales are up by a below-trend 2.0% over the year to June, while sales volumes have contracted marginally, down 0.6% over the year.

The most recent data for Q2 showed an acceleration, with improving sales in May and June driven by consumers taking advantage of early end of financial year promotions and sales events. This is indicative of the current spending pattern whereby consumers are cautious and managing their budget carefully, resulting is stronger sales activity in periods of greater discounting, notably May and November.

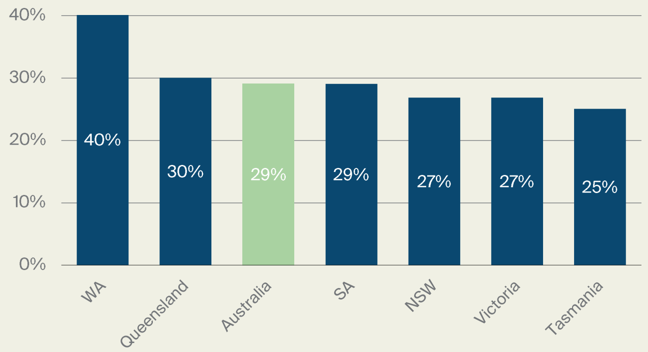
Looking ahead, the outlook for retail sales is improving as some of the pressures on household budgets start to ease. Retail sales are forecast to rise by 3.0% in 2025 in nominal terms and by 2.0% in volume terms, which should provide a boost to discretionary spending on items that have lagged over the past year, such as household goods and clothing.

SALES STILL ABOVE PRE-PANDEMIC TREND

While recent growth has been slow, retail sales are still well above the pre-pandemic trend. Sales escalated sharply from late 2021 and throughout 2022 and this behavioral shift is yet to fully unwind, with several factors supporting aggregate spending across the economy in spite of cost-of-living pressures. These include rapid population growth, significant savings buffers and a positive wealth effect from the rally in equity markets and house prices over the past 12 months.

Retail sales by state

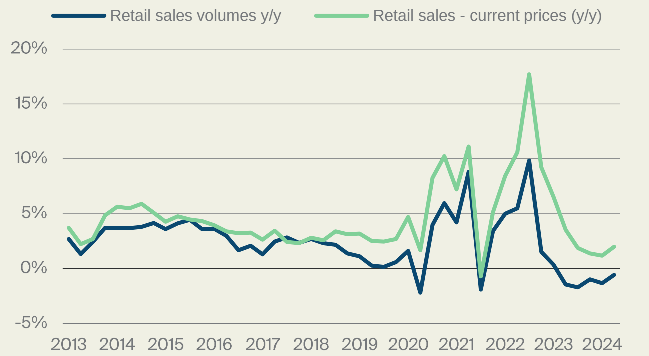
Per cent change Jan 2020 - May 2024



Source: Knight Frank Research, Macrobond

Retail sales growth trending upward

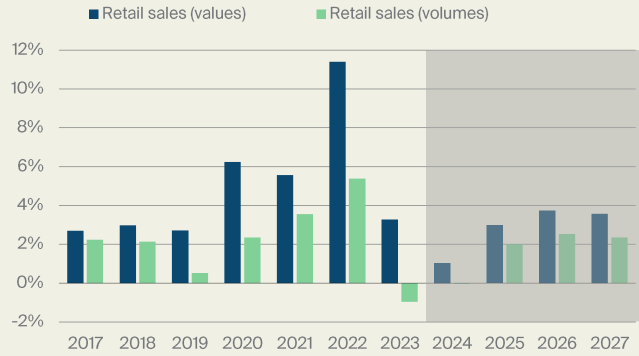
Retail sales growth - total volumes and in current prices



Source: Knight Frank Research, Macrobond

Improving retail sales outlook

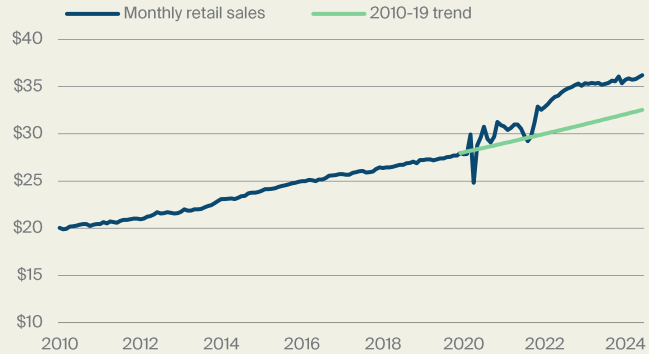
Historic and forecast retail sales growth



Source: Knight Frank Research, Oxford Economics

Sales remain well above pre-pandemic trend

Monthly retail sales (billions)



Source: Knight Frank Research, ABS

Return to income growth

Welcome improvement in leasing spreads and MAT

LEASING SPREADS AND MAT GROWTH DEMONSTATES RESILIENCE

Despite a challenging economic backdrop, retail owners have reported a strong turnaround in leasing spreads, with a broad-based return to growth in FY 24. In 2021 and 2022 lease spread data had bifurcated with stronger performance in neighbourhood centres dominated by non-discretionary tenants, but now growth has returned across all centre types. Operators of major shopping centres, such as Vicinity and Scentre group returned to growth, reporting 3.0% and 3.1% respectively, while operators of smaller neighbourhood assets such as HomeCo (5.9%) reported a continuation of solid growth.

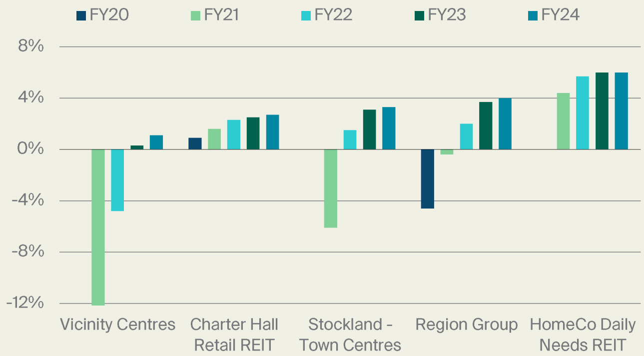
In addition, major shopping centres have experienced a return to solid growth in MAT over the past year, with most major centres experiencing growth of 4-6% supported by strong population growth and the gradual restoration of centre visitation after the disruption caused by the pandemic. Aggregate visitation levels are moving back toward 2019 levels and this is translating to renewed interest from retailers in striking new leases.

EBIT MARGIN DATA UNDERPINNING OPTIMISM

Major retailers have also coped well despite the challenging macro climate. A review of EBIT margin data across a selection of well-known Australian retailers reveals resilient performance from many groups and some significant increases in profitability compared to the pre-pandemic trend. The improvement comes in spite of rising staff costs and subdued discretionary spending, which augurs well for profitability to rise further as the outlook improves in 2025.

Leasing spread by major owner

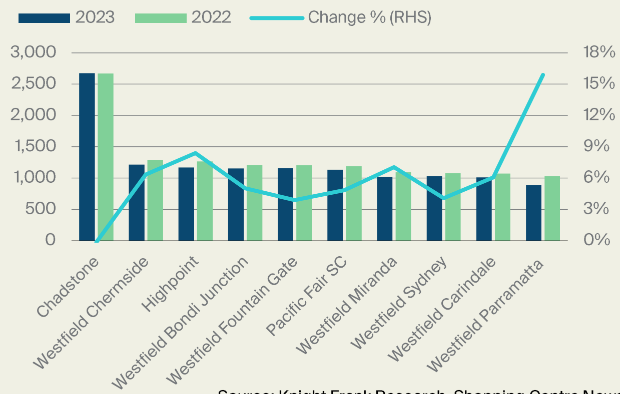
Annual change as reported by financial year



Source: Knight Frank Research

Estimated MAT and annual growth by centre

AUD millions



Source: Knight Frank Research, Shopping Centre News

Reported EBIT margin in FY24 (%)

Retailer	FY24
Supercheap Auto	14.8
Shaver Shop	10.0
Rebel	9.4
Michael Hill Australia	8.1
BCF	7.6
JB Hi-Fi Australia	7.4
Woolworth Food Retail	6.0
The Good Guys	5.9
Coles Supermarket	5.2
Coles Liquor	3.6
Big W	0.3

Source: Company annual reports

Australia's retailing resilience

Less supply and a slower take-up of online sales have helped Australia

LESS RETAIL SUPPLY PER CAPITA

In recent years, retail investment performance has been relatively weak in key markets overseas like the US and UK. However, in Australia the sector has been more resilient and this can be explained by several differences between our market and the retail experience elsewhere.

Firstly, Australia has considerably less supply on a per capita basis. A study from the International Council of Shopping Centres highlighted the limited per capita supply of shopping centre space in Australia. Estimated stock in 2023 of 26.5 million sqm in Australia equates to 1.06 sqm per capita, less than half the US supply, with a higher proportion of stock leased to resilient major tenants that anchor the Australian retail landscape such as our largest supermarkets.

Looking ahead, the development pipeline remains very limited, partly owing to the steep rise in construction costs. Major owners are more focussed on optimising the performance of existing assets rather than expanding their holdings through development.

FASTER POPULATION GROWTH

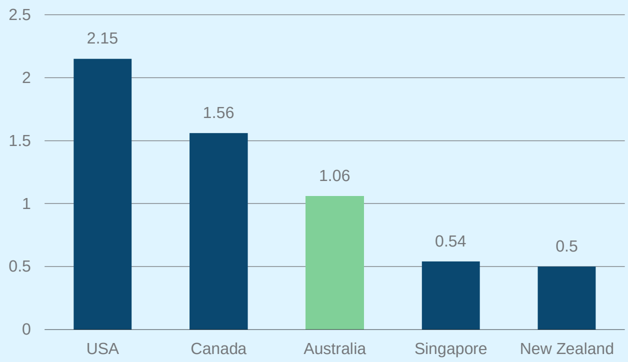
Related to this, Australia's strong population growth is contributing to low per capita supply and underpinning high visitation levels and MAT growth in the major centres. Over the year to December, the population expanded by a further 651,200 people, reflecting growth of 2.5%, the fastest since the early 1970s. Even as growth slows, it is likely that Australia will still expand much faster than peer advanced economies such as Canada, the US and UK, given that our historic growth trajectory demonstrates much faster trend growth. Over the past 20 years, Australia's population has expanded by 6.8 million people, equating to 1.5% per year.

SLOWER GROWTH IN ONLINE RETAIL

Australia's lower online retailing presence, sitting at 11.6% of total retail turnover, further reinforces the comparative resilience of in-store retailing here. Whereas the online penetration rate has reached 30.6% in the UK and 15.8% in the US, Australia has been slower to see a similar shift online.

It is likely that the greater geographic dispersion of Australian cities makes it more difficult to achieve the same economies of scale for retailers and logistics providers. While the online share is likely to increase over time, recent experience demonstrates that this will be a slow process and that retail owners will have time to adapt.

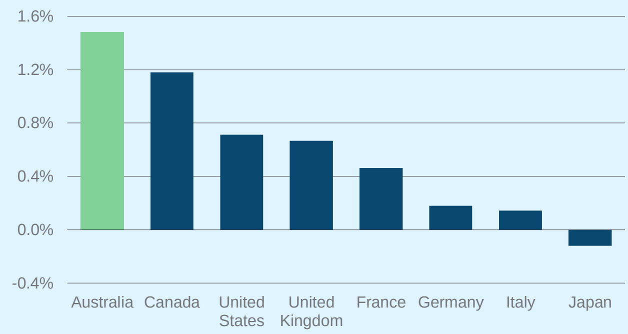
Retail stock per capita (sqm) - by country



Source: Knight Frank Research, ICSC

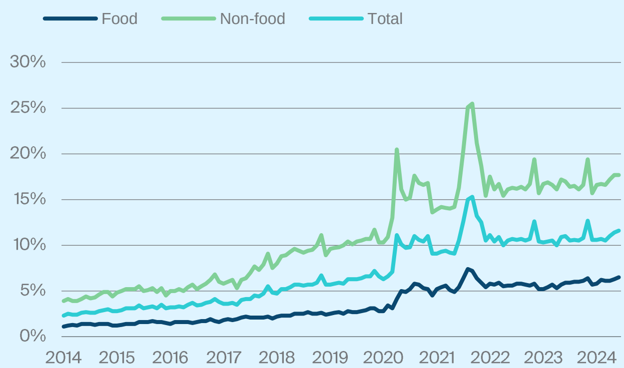
Population growth in major economies

Average annual growth - past 20 years 2003-2023



Source: Knight Frank Research, IMF

Online sales as a share of total retail sales



Source: Knight Frank Research, ABS

Capital markets

Liquidity improving as uncertainty clears

HIGHER DEAL VOLUMES AS INVESTORS RESPOND TO INCOME GROWTH

In keeping with the slowdown across all asset classes, total investment volumes in the retail sector were subdued in 2023, with $5.2 billion traded. However, activity has picked up strongly in 2024, with $3.9 billion traded in the first half of the year, 46% up on the low total in H1 2023. NSW has led the way with $1.4 billion traded, followed by Queensland and Western Australia with around $700 million.

Investors are responding to the prospect of an improving economic climate, with uncertainty around the outlook for inflation and interest rates no longer such a brake on deal activity. The improvement in leasing spreads and MAT levels is also persuading more investors that the sector has been resilient through this period of consumer weakness and offers long term growth potential as the economy recovers.

As a result, the market for retail assets is proving to be more liquid than office markets, and the outlook for income growth is arguably the best among the major sectors.

PRIVATE CAPITAL DRIVING THE MARKET

The change in investment market conditions over the past two years has led to a significant shift in the composition of the investor mix seeking exposure to the retail sector. Domestic institutions and cross border investors have largely sat on the sidelines, while listed groups have opted to reduce their holdings and private investors have been the most active buyers.

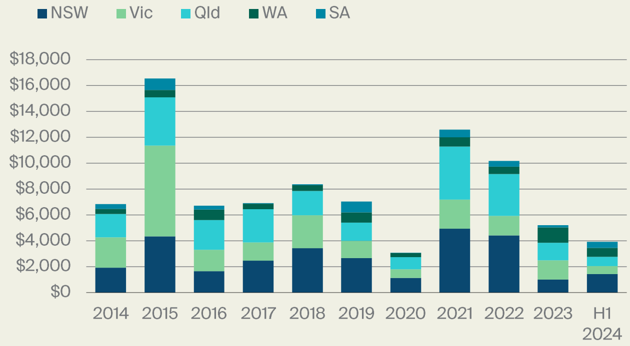
Private investors tend to be more opportunistic and have historically been relatively active during periods of uncertainty and less liquidity, but as sentiment improves, we expect the investor base to broaden out with institutional capital likely to return.

CAMPBELL AITKEN
Head of Retail Investments

Since the start of this year, we have seen a return to confidence, and with that has come a constant flow of transactions.

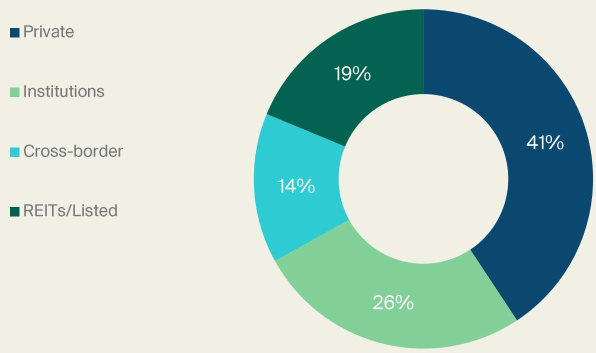
Investors who have previously avoided the retail sector are now looking more closely, having been attracted by the resilience of centre turnover and the increasingly positive outlook for income growth. Many current active buyers are acquiring retail assets for the first time.

Shopping centre investment volumes
Invetsment volumes nationally and by state (AUD millions)



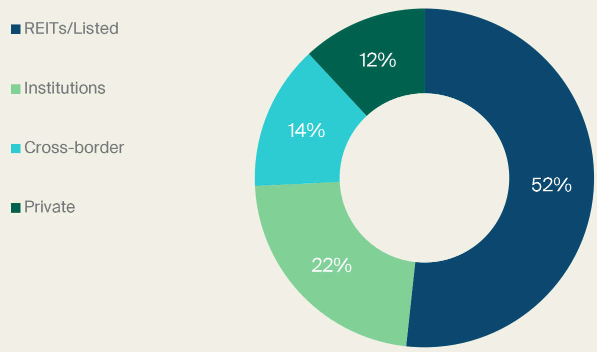
Source: Knight Frank Research, RCA

Largest sellers of retail 2023-24
Proportion of total sales by vendor type



Source: Knight Frank Research, RCA

Largest buyers of retail 2023-24
Proportion of total purchases by buyer type



Source: Knight Frank Research, RCA

Pricing and returns

Valuations still adjusting, but sentiment on the rise

YIELD SHIFT STILL UNDERWAY BUT RETAIL HAS BEEN LESS IMPACTED THAN OFFICE AND INDUSTRIAL

Yields have continued to rise as markets continue to adjust to the higher interest rate environment. However, retail has been less impacted than office and industrial markets that were priced more sharply prior to the correction, given that retail yields had previously shifted out during the pandemic. Average retail yields have moved out by only 50 basis points over the past two years, while average office and industrial yields have risen by 110 and 130bps respectively. As a result, average office yields have surpassed retail yields after edging lower during the pandemic.

The performance delineation that emerged during the pandemic, with neighbourhood centres outperforming, has lessened with yields trending out at different rates across all asset types. Cap rates for the more sharply priced neighbourhood and major regional centres were more immediately susceptible to the higher cost of debt and so shifted out more quickly, while sub-regional centres were generally held at higher rates and have seen a slightly smaller adjustment.

SENTIMENT IMPROVING AS THE RISK OF FURTHER RATE HIKES DIMINISHES

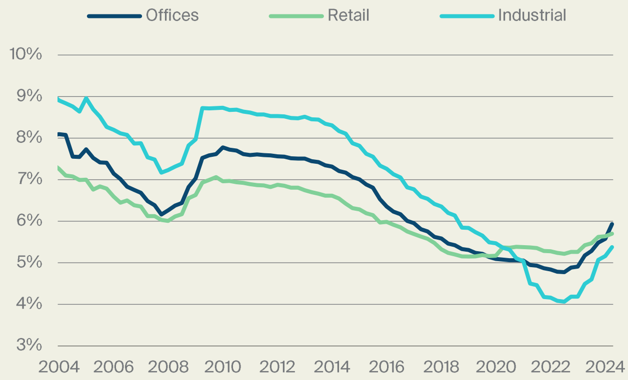
While valuations have lagged and may have a little further to adjust, pricing does now appear to be stabilising, and retail is well placed to benefit from rising income returns as the market enters a recovery phase in 2025. Uncertainty over the outlook for interest rates is now easing, with markets pricing in cuts by mid-2025 to a terminal rate of 3.0-3.5%, and investors increasingly perceive an opportunity to acquire assets at a cyclical low point that will pave the way for strong performance in years to come. Even if rate cuts do not come through as quickly as markets anticipate, downside risks have reduced and sentiment is improving in response to recent evidence of resilient trading performance in the major centres and from the major retailers.

HANNA CLARKE
Head of Retail Valuations

The last 12-24 months has seen a reset for retail assets across the board.

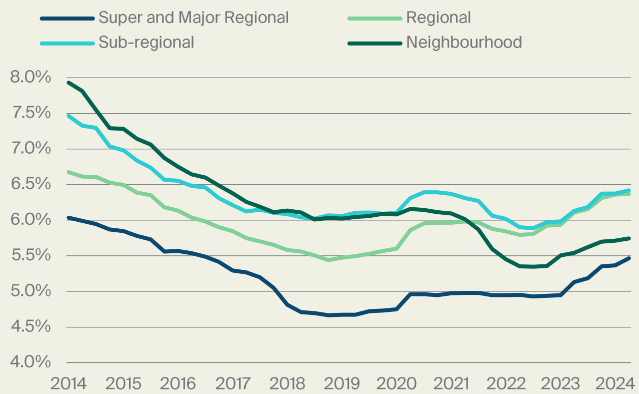
Looking forward, the descending projection for inflation and cash rates globally, ultimately point to the beginning of a new cycle with what we anticipate will be an increasingly positive outlook for capital growth.

Comparing average cap rates across sectors



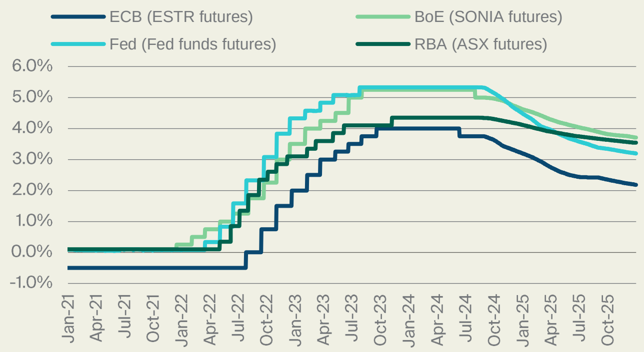
Source: Knight Frank Research, MSCI

Average retail cap rates by type



Source: Knight Frank Research, MSCI

Policy rates expected to fall in 2024-25
Implied forecasts of central bank policy rates based on market pricing (%)



Source: Knight Frank Research, Macrobond

Recent transactions

Location	Property	Date	Price (m$)	GLAR (m^2)	Purchaser	Vendor	Initial yield %
Kingborough, TAS	Channel Court **	Jul-24	82.5	25,532	Nick DiMauro	Challenger Life	7.71
Northern Beaches, NSW	Dee Why Grand	Jul-24	60.0	9,976	Wingdom	ISPT	6.54
Adelaide, SA	Westfield Tea Tree Plaza (50%) *	Jun-24	295.8	99,979	Scentre Group, Barrenjoey Private Capital	Dexus	7.79
Wingecarribee, NSW	HomeCo Highlands	Jun-24	46.3	11,482	F.T.D. Holdings	HomeCo Daily Needs REIT	6.18
Maitland, NSW	Rutherford Marketplace	May-24	49.8	6,867	Rutherford Property Holdings	Charter Hall Retail REIT, Telstra Super	6.01
Weston, ACT	Cooleman Court	May-24	74.0	10,469	Region Group	Mirvac	6.77
Wollongong, NSW	The Bayview Centre	May-24	57.0	10,729	Property Plus Trust	Griffith Capital	5.50
Mandurah, WA	Halls Head Central	May-24	69.8	19,373	Centuria Capital	Vicinity Centres, ISPT	8.61
Karratha, WA	Karratha City	May-24	95.9	22,990	Fawkner Property	Vicincity Centres, Challenger	7.52
Lake Macquarie, NSW	Stockland Glendale **	Apr-24	315.0	52,350	IP Generation	Stockland	6.63
Sydney, NSW	West Ryde Market Place	Mar-24	60.2	6,384	HomeCo Daily Needs REIT	Primewest Group	5.55
Gosnells, WA	Maddington Central	Mar-24	107.0	27,645	Realside	Vicinity Centres	7.12
Sydney, NSW	Pemulwuy Marketplace	Mar-24	40.0	5,211	Revelop (AUS)	Primewest Group	5.51
Sydney, NSW	Kirrawee Shopping Centre **	Mar-24	39.4	5,042	Revelop (AUS)	Fabcot	5.82
Adelaide, SA	Kurralta Central	Feb-24	74.3	10,674	Coles Group	Vicinity Centres	4.26

* Main centre yields – not blended; total sale price included
** Acquisition valuer analysis adopted

Source: Knight Frank Research / RCA

We like questions, if you've got one about our research, or would like some property advice, we would love to hear from you.

Research
Ben Burston
+61 2 9036 6756
Ben.Burston@au.knightfrank.com

Asset Management Services
Lisa Atkins
+61 3 9604 4710
Lisa..Atkins@au.knightfrank.com

Retail Investment
Campbell Aitken
+61 2 9036 6641
Campbell.Aitken@au.knightfrank.com

Retail Investment
Chris Maher
+61 7 3246 8876
Chris.Maher@au.knightfrank.com

Valuation and Advisory
Hanna Clarke
+ 61 400 366 125
Hanna.Clarke@au.knightfrank.com

Retail Leasing
Alex Alamsyah
+61 2 9036 6693
Alex.Alamsyah@au.knightfrank.com

Australian Industrial Report

Economic Indicators Report

Sydney City Fringe Office Market Report

Australian Horizon Report

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