1. *Evidence points to renewed bricks and mortar participation*
2. *Online retailing levels stabilise at around 10% post-Covid*
3. *Regional centres invest in fight back against on-line*

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Australian Retail Review

September 2023

KEY INSIGHTS

1.6%
GDP growth forecast 2023 (1.7% for 2024) IMF

25bps
Shift in retail yields in major markets during Q2 2023

37%
Retail's share of big 3 sectors investment transactions (Q2 2023)

3.7%
Unemployment remains low and high participation rate of 66.7%

4.10%
Interest rates in September

"Consumers show a renewed interest in bricks and mortar, with the retailing experience an increasingly dominant factor"

Interest rates remained at 4.1% in September. With interest rates again kept on hold, it is hoped that we are there, or thereabouts on peak interest rates.

Population forecast to grow 21% from 2023-41, and will reach 31,433,000 by 2041.

Inflation fell to 6% in Q2 2023, from a high of 7.8% at the end of last year and 7.0% in Q1. However, this still remains considerably above the RBA target band of 2-3% and is driving interest rate rises. Most forecasts expect this figure to be back in the 3-4% range by end of Q2 2024.

GDP growth has steadily been declining and the forecast for 2023 is at a new low of 1.6%. However, a full-blown recession is not forecast, just a sharp slowdown with retail sails showing signs of falling.

Business conditions are some of the strongest on record, however business sentiment remains poor. Businesses are seeing the forthcoming headwinds as of concern for the wider market, as interest rates have risen considerably.

Australia's labour market is tight, with continued near record low unemployment. Underemployment also remains low whilst the participation rate remains high.

Key indicators	Retail turnover (Change 2022-2023)	Employment growth (2022-2023)	Unemployment rate	Net Overseas Migration	Population Growth
Victoria	3.18%	2.24%	3.7%	1.48%	1.65%
New South Wales	2%	2.82%	3%	1.36%	1.34%
Queensland	(1.09%)	6.51%	3.9%	0.82%	2.18%
Western Australia	3.82%	1.95%	3.7%	0.85%	1.83%
South Australia	3.17%	1.64%	4%	1.08%	1.40%
Tasmania	4.55%	0.2%	4,2%	0.59%	0.73%
Total Australia	4..21%	2.21%	3.5%	0.82%	1.63%

ECONOMIC OVERVIEW

Retail growth stalls with impact of higher inflation and interest rates on consumers

Australian economy expected to remain resilient

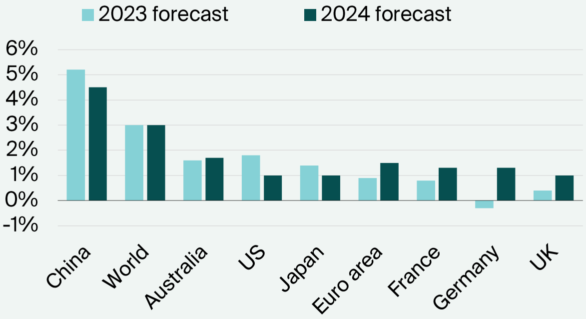
Compared to 2022, when GDP grew by 2.7%, the Australian economy is facing slowdown in 2023 (1.6%) and into 2024 (1.7%) according to the IMF. However this is still a relatively strong performance compared to other industrialised economies as we benefit from exposure to Asian markets.

Price pressures moderate but remain high

Inflation is now showing clear signs of slowing down in both the quarterly and monthly numbers. Having peaked in December (8.4% monthly and 7.8% quarterly), the headline rate has been coming down quiet rapidly (5.4% monthly and 6.0% quarterly as of July). The trimmed mean also sits at 6.0%. Though this is still well above the target for the RBA the rapid downward decline combined with news on the retail front is enough to pause rates.

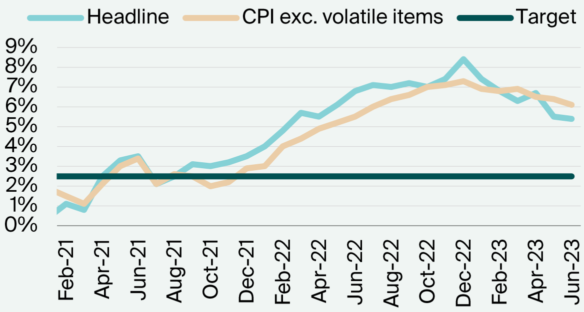
IMF GDP forecast

GDP forecasts, Jul-23



Source: Knight Frank Research, IMF

Inflation is starting to fall



Source: Knight Frank Research, ABS

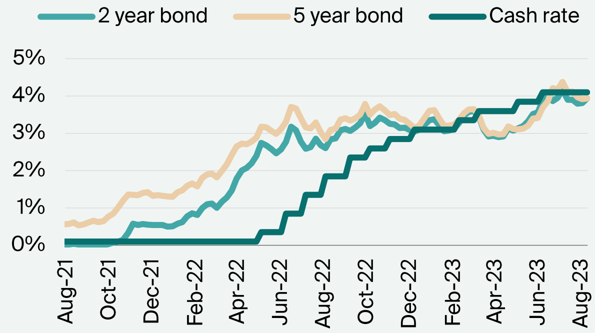
Interest rate peak in sight as retail sales stall

Interest rates were put on hold again in September but have been raised substantially since early last year. Market indications are that we may be near the peak of the present interest rate cycle. Whilst the labour market has remained surprisingly resilient, enough data from the consumer, the economy and the CPI are present to show the economy is cooling.

Price pressures moderate but remain high

Australian retail sales rose slightly by 0.4% in Q2 2023 after having fallen in Q1 (0.1%). However, given recent price rises, volumes is a more telling statistic. Volumes fell for the third quarter, down 0.5% in Q2, following falls of 0.8% and 0.4%. It is expected that the retail environment will remain difficult throughout 2023 and 2024.

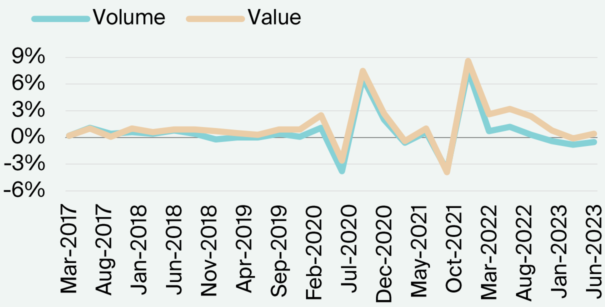
Australian interest rates



Source: Knight Frank Research, Macrobond

Retail sales - values versus volumes

Quarterly growth rate %



Source: Knight Frank Research, ABS

DRIVERS OF RETAIL DEMAND

Conflicting signals as population growth returns while consumer sentiment dips

Return of net migration boosting demand

The Australian retail market has historically benefited from strong population growth. Over the three decades to 2022 Australia's population grew at 1.3% per year. Australia has particularly benefited from net overseas migration which contributed over half of the total population increase. Apart from a brief interruption during Covid, there has been a steady increase in numbers from a net inflow of 69,000 people in 1991–92 to 241,000 people in 2018–19. Figures for 2023 show a strong recovery as international students return.

Consumer confidence struggles to recover as interest rates rise

Despite the reopening of the country both nationally and internationally, together with a bounce back in growth and retail sales, consumer confidence has remained fragile. The initial post-Covid exuberance has been replaced with concern over increasing interest rates. The retail market remains delicate with confidence levels remaining low in the last few months even as interest rates have been on hold. Confidence is just above 80, having been around the levels seen during the GFC for most of the year.

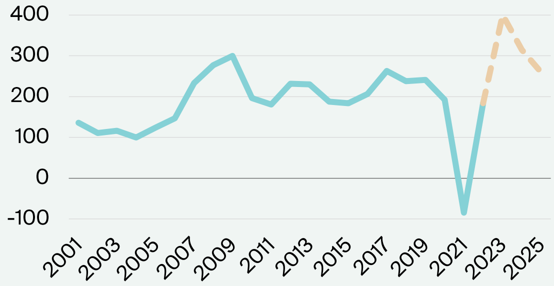
Online share of sales has stabilised

Even prior to Covid, there had been a slow but steady increase in online shopping's share of the retail market. The pandemic turbocharged the move, and for a short while 25% of non-food sales were through the internet.

However post-Covid the level has stabilised at 10% overall. Whilst this has meant holding on to much of the growth of recent years, the continual rise in sales has, at lest temporarily paused. The latest Auspost report (2023) suggest that as a nation we have reached a period of flatlining for online shopping. There was a record retail spend in 2022 ($353 billion), up 9.2% y/y. However, online spend only rose 1.7%, with the number of purchases actually falling.

Net overseas migration

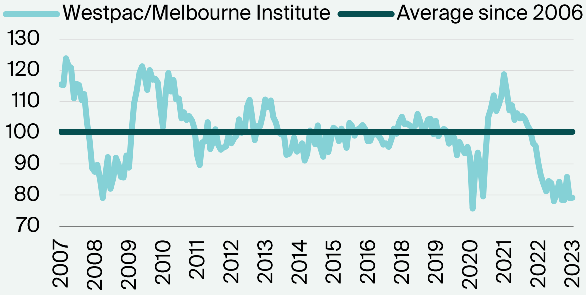
Australia - annual total '000s



Source: Knight Frank Research, ABS

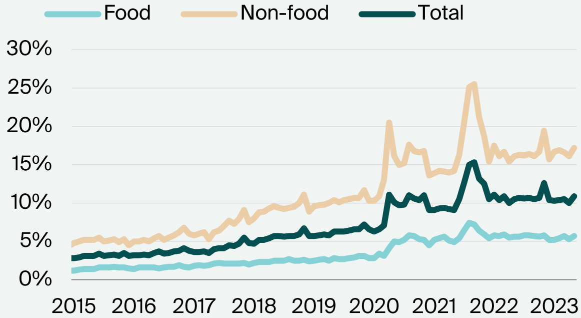
Consumer confidence

Index, value above 100 denotes optimism



Source: Knight Frank Research, Macrobond

Online sales as a share of total retail sales



Source: Knight Frank Research, ABS

RETAIL TURNOVER TRENDS

The bounce back continues as Western Australia leads the way

Strongest sales growth in WA

Despite the recent slowdown, retail sales have risen strongly across Australia since 2020. Tasmania continues to struggle, compared to the other states with faster population growth, whilst Western Australia stands out on in the other extreme, with a fast growing, commodities rich economy. It is clear from its laggard performance, that Victoria's onerous and extended lockdowns had a negative impact on spending and whilst it has recovered, the recovery has been slower than for most other states.

CBD centres return to growth

Covid put particular pressure on the CBD market and caused a major reduction in CBD retail patronage, as working from home, office closures and lockdowns deadened city centres. The past year has seen a substantial improvement in CBD trading, but these markets are yet to fully recover. Regional and super-regional centres were also affected, but had a more limited hit and their turnover has generally recovered following the more pro-active measures centre owners have taken to get shoppers back.

The winners from the recent trends in the economy have been local centres and supermarket anchored centres. These classes initially benefitted from people having to stay local, and have managed to maintain these gains as the economy re-opened.

Food spending remains resilient

Unsurprisingly basic food spending has been resilient and remains so. Supermarkets and mini-major stores have generally been unaffected by recent events and performing in line with medium term trend growth.

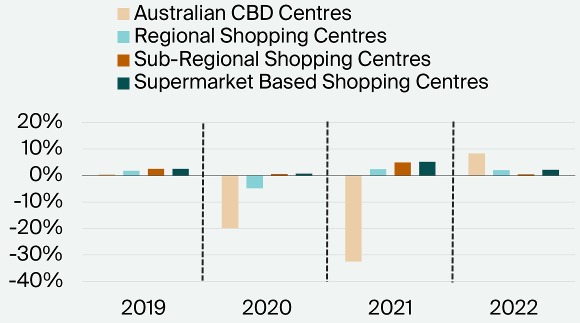
Department stores had a difficult time during lockdown, but both Myers and David Jones announced strong bounce backs with positive news on sales, though this has slowed due to present economic events. Conversely, discount department stores that had benefited during Covid have given up some of their gains.

Retail sales by state

Per cent change since Jan 2020

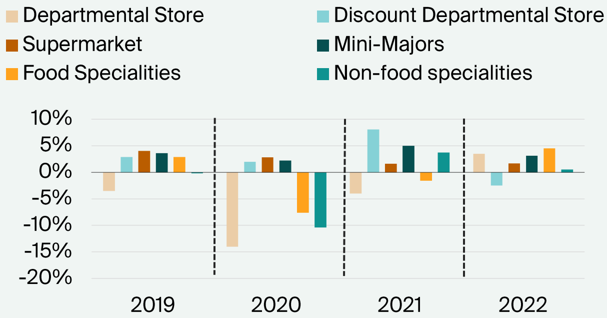
Source: Knight Frank Research, Macrobond

Stable centre MAT growth by centre class



Source: Knight Frank Research, Urbis

Stable centre MAT growth by category



Source: Knight Frank Research, Urbis

TRANSACTIONAL ACTIVITY

Limited interest in the retail sector remains as overall transactional markets are quiet

Limited turnover but solid underlying demand

With the rise of interest in industrial real estate and the continued popularity of offices, compounded by uncertainty over Covid, the retail sectors share of investment activity had declined to just 18% in 2020. However, retail's share of investment activity has actually been rising in the post-Covid era. Indeed, investment volumes in 2021 and 2022 have been above the 10 year average, as the (until recent) retail boom provided some degree of confidence in the sector. This has continued into 2023, and whilst overall activity, including retail, has been rather muted, the relative interest in the retail market has remained.

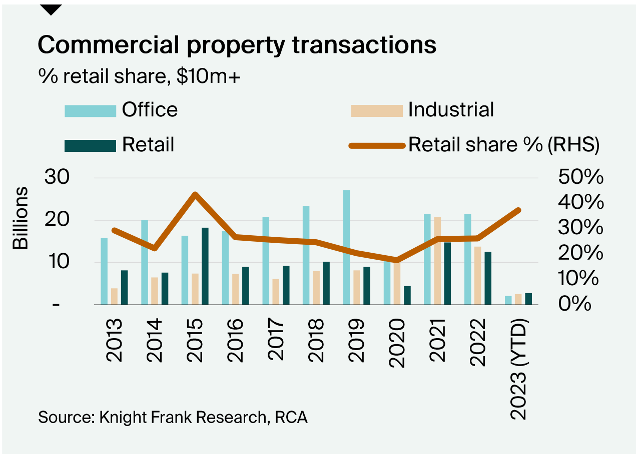
Retail recovery hit by a weakening economy

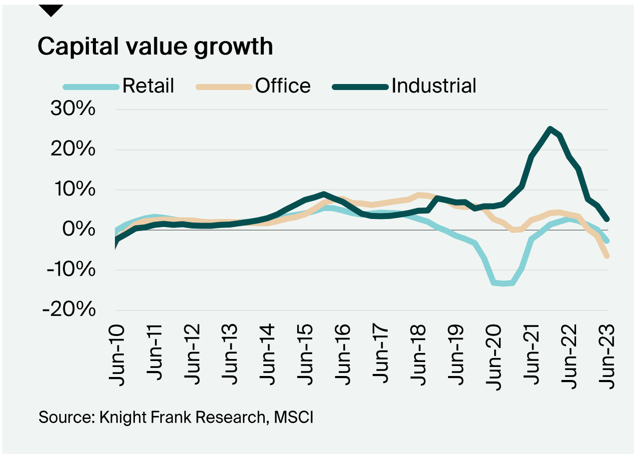
There had been talk of retail's demise, however, as in previous iterations of the sector, the market's repositioning of itself (combined with some re-pricing) has improved its attractiveness to investors. Consequently, there was a brief return to capital value growth in the market, until the recent downturn in the economy hit values across the real estate market.

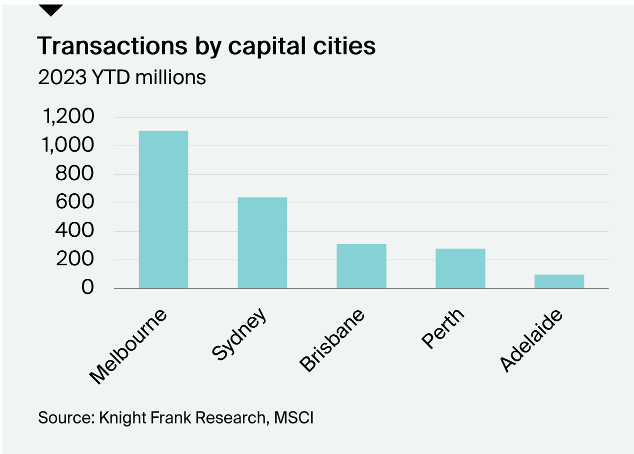
Retail has always adapted as it faced headwinds and in the last three years we witnessed the retail investment hierarchy realign. As we move forward, retail offerings e.g. weighting (or lack of) to non-discretionary, will continue to adjust and remix.

Largest deal since 2021 as Craigieburn is sold, but values are down

The largest sale of the year (and since December 2021 in Australia and for five years in Victoria) came with the sale of Craigieburn Central, Melbourne by Lendlease to IP Generation for $300m in April. The mall is a sub-regional shopping centre covering 64,000sqmof GLA land area, with 75,000sqm of attached land suitable for expansion. This deal was first mooted in 2020, but was delayed due to pricing uncertainty in the market. It was hoped that the mall, which is in a rapidly growing part of Melbourne, would trade for $350m in 2020. Consequently, it sold at a discount of around 15% to pricing expectations before the pandemic.







INVESTMENT PERFORMANCE AND OUTLOOK

Recovery from Covid stalls as financial environment adds to the sector's difficulties

Repricing starting to adjust, but yet to fully play out in formal valuations

The traditional order of yields, had been diminishing throughout the decade leading up to Covid, particularly the premium given to industrials. However, this accelerated markedly during Covid. The relative repricing of both retail and industrials flipped the historic order of things in terms of yield profiles. However, this now makes retail less susceptible to the effects of the higher funding cost environment to some extent, as it has already adjusted to a higher yield level.

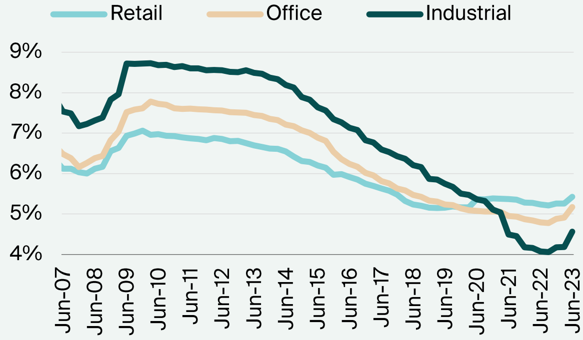
The yield weakness in retail was exacerbated by the rental declines in many major shopping centres during Covid. The hit to total returns has been particularly hard for the larger super regional and regional centres most exposed to the impact of shutdowns which saw double digit negative total returns. For neighbourhood centres, total returns were around –2% and rebounded strongly as the economy re-opened (+14%).

Outlook improving as rates stabilise and focus turns to potential cuts in 2024-25

With uncertainties continuing in the financial markets, bond rates have continued to fluctuate. Yields across all sectors have continued to be under pressure and are expected to move out though 2023 resulting in renewed downward pressure on total returns. It is expected that there will be a slight rebound in 2024 as certainty returns. Consequently, growth in values will be expected to come more from rental growth.

It is expected that neighbourhood centres will continue to perform strongly as demand for their offer remains, almost regardless of other events. The major shopping centres are expected to see some resurgence in demand, following on from the large scale investments that have been put in place as they seek to remain relevant in the new consumer environment. Sub-regional centres will find things more difficult in this environment. For CBD retail, population growth and the return of international travel will all help re-invigorate the city centres. However, the impact of working from home on office life, and thus the week time footfall for businesses, will have a continued drag on performance in specific offerings if the trend remains.

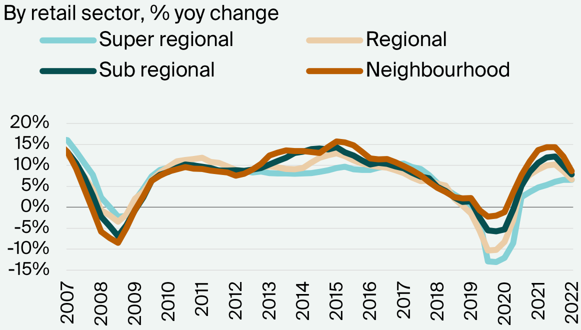
Sector yields



Source: Knight Frank Research, MSCI

Total returns

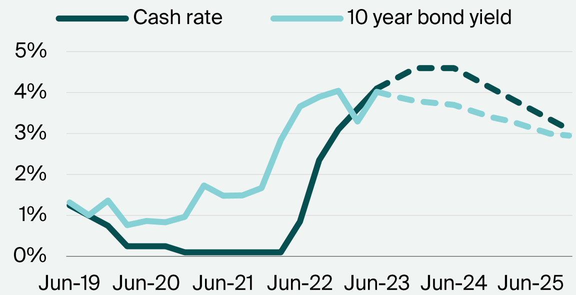
By retail sector, % yoy change



Source: Knight Frank Research, MSCI

Interest rate outlook

Cash rate and 10 year bond outlook



Source: Knight Frank Research, Oxford Economics

STRATEGIC SHIFTS

The repositioning of bricks and mortar — Major retailers shifting their approach in the aftermath of the pandemic and pressures on consumer spending

"Retail has been a resilient asset class – the underlying principles remain sound, Aussies really do prefer to go shopping every week. " Jeremy Prestoe—AMS

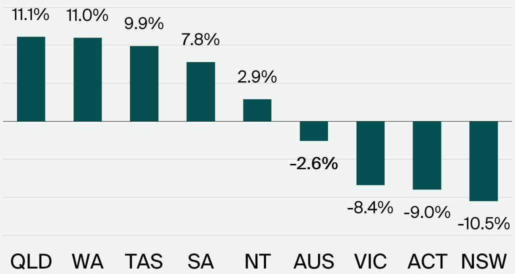
Online share has stalled but continues to impact the retail landscape

The retailing environment experienced significant change due to the pandemic, and the increase in online retailing that it drove. The market has experienced shifts not only in spending patterns between different types of goods, and the flow through of this in occupancy costs to retailers, but also in forced or preferential changes in consumers' choices of preferred centre types.

Online retail market penetration was 10% after its initial early 2000s growth. This increased as states endured lock downs and restrictions on movement. The latest Auspost report on online spending suggests that as a nation we have reached a period of flatline. Australians spent a record $353 billion on retail in 2022, yet online retail purchases declined 2.6% y/y. According to the report, for the first time since the pandemic, online penetration softened even though household participation was stronger. This suggests that while households are now more comfortable utilising online retailing for smaller, non-discretionary spend, the re-opening of traditional retail is encouraging an uptick of retail spending in this area. The slowing in online spend shows that its expansion will be far more gradual than widely feared.

Growth in e-commerce has stalled

% change in purchases 2022



Source: Knight Frank Research, Auspost

Adapting shopping centres

As we move on from the pandemic, shopping centres are accelerating an effective countermeasure to online shopping—making centres destination locations. For instance, Chadstone has invested $70m in new dinning and entertaining facilities, including having 'Holey Moley' golf within its offer. Other centres now have basketball courts, bowling alleys and sports bars, as well as improved food malls, cinemas and evening entertainment to make the whole experience more of a day out. This repositioning, and where needed repurposing, is reasserting bricks and mortar offers after a period of significant on-line and e-tailing focus. In-store purchases have regained popularity, but so has click and collect highlighting, in this omni-channel retailing world, the continued need for the physical store and the importance of making it an attractive offering.

Recovering CBDs

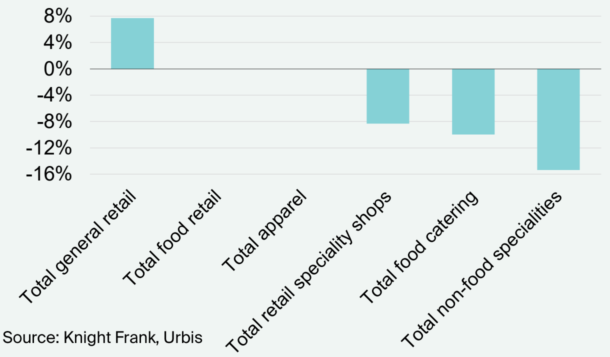
Even the hardest hit CBDs of Melbourne and Sydney are seeing the green shoots of a retail recovery that will be encouraged by more workers returning to the office more regularly. In Melbourne, Thursday footfall is now at 85% of pre-pandemic levels, but more importantly weekend and evening numbers are higher than in 2019 as the CBD comes to life outside of working hours. CBDs are repositioning to present a more attractive offer to non-office workers, as tourist and student numbers recover more rapidly than daytime trade involving office workers. A spruce up of the offer and selective tenant choice is needed to help the CBD adapt to be less beholden to 9-5 trade.

"The old adage of 'adapt or die' has always been prevalent in retail….. and nothing has changed." Chris Maher—Head of Retail Investment

SUPER REGIONAL & REGIONAL CENTRES

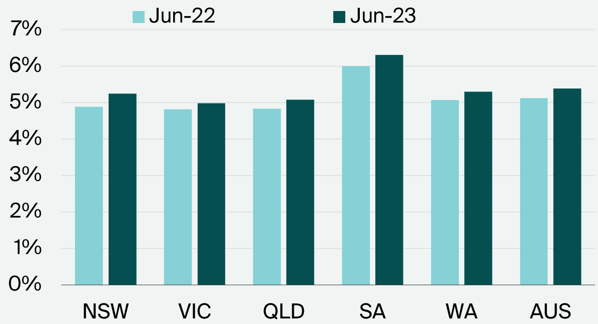
Mixed results with some strength on the back of increased local demand, while changes in approach to retail delivery are reflected in some declining MAT figures

Regional centre MAT (per store)



Source: Knight Frank, Urbis

Super Regional and Regional centre yields by state



Source: Knight Frank Research

Large centres hold up in tough environment

The performance of regional shopping centres has remained mixed with less uniformity in retailing performance than in CBD centres. Specialties were negatively affected, reflective of lessened discretionary spending driven by the over-arching cost-of-living increases and broader economic challenges. Food catering and non-food specialities showed losses in MAT in line with broader retail trends.

Lesser impact than CBDs but yields rise and rents fall in general repricing

In line with market trends, regional centre yields have also moved out from 5.1% a year ago to be at 5.4%, though they remain below CBD levels. Victoria has the lowest yields is just keeping below 5% on average at 4.98%, however there is a mixed basket of assets and the figure is helped by large traditional shopping centres managing to hold on to their value.

Gross rents on per sqm basis in regional shopping centres showed a uniform, small decline over the period; reflective of trading limitations. The decline in gross rents for food catering were the most significant, reflecting the particular challenges this retail category faced.

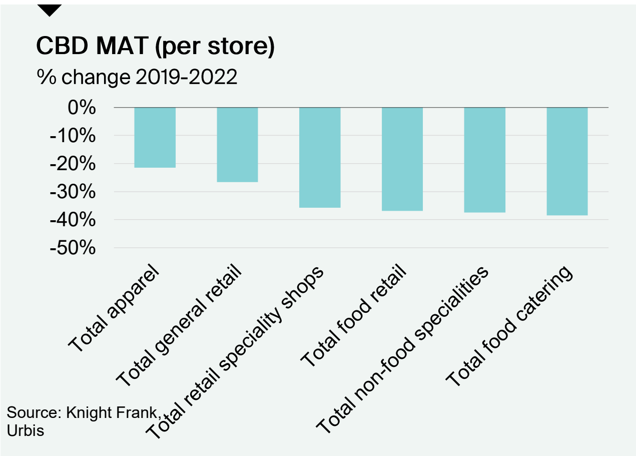
GLA's increased across most categories, which is an illustration of the continued investment in this centre classification, as offers have been expanded to attract back shoppers.

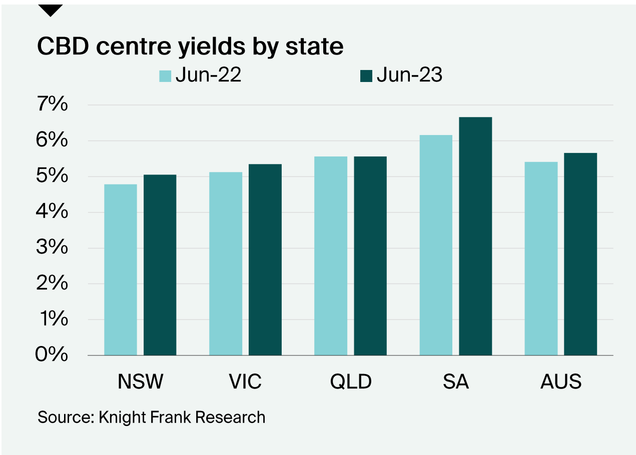
Regional Shopping Centres

	2019 GLA (per store) sqm	2021 GLA (per store) sqm	2022 GLA (per store) sqm	% Change 2019-2022	2019 Gross Rent (exc. market levy) $ psm	2021 Gross Rent (exc. market levy) $ psm	2022 Gross Rent (exc. market levy) $ psm	% Change 2019-2022
Total food retail	100	106	109	9.00%	1714	1,556	1,609	-6.13%
Total food catering	79	84	88	11.39%	2109	1,949	1,914	-9.25%
Total apparel	140	151	157	12.14%	1709	1,567	1,567	-8.31%
Total general retail	128	145	145	13.28%	1701	1,504	1,558	-8.41%
Total non-food specialities	129	126	130	0.78%	1776	1,640	1,647	-7.26%
Total retail speciality shops	109	116	120	10.09%	1836	1,683	1,685	-8.22%

CBD BASED CENTRES

Pricing, rental cost and space metrics have shifted with CBD retailing the most heavily affected





CBD centres still in recovery phase

CBD based centres struggled the most of the three centre types reviewed, with a marked decline in the MAT for all retailing classes between 2019 -2022. This is clearly linked to transformational change within the CBD environment, namely lockdowns, extended periods of working from home and then hybrid working. This market segment is faced with significant challenges in the short-medium term across the board. Owners need to inject significant capex to help with the rejuvenation of assets to attract trade and consumer visits, which, though recovering, remain below long-term averages.

Yields hit in weak investment market, but rental repricing has occurred

The weak investment market continues to impact pricing. Yields have risen across all the states in the last year, with the exception of Queensland. Yields are now averaging 5.7% from 5.4% a year ago, with South Australia an outlier at 6.7%. This does provide attractive income opportunities.

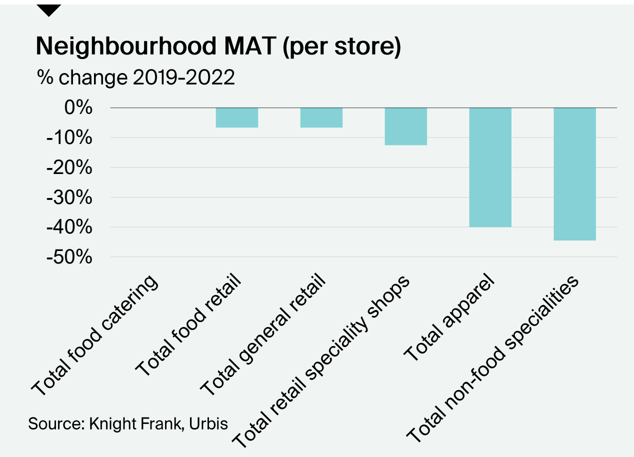
Australian CBD centres saw all rents on a psm basis (save for total food retail) fall back markedly. This highlights the heavy hit that was taken by the CBDs during the lockdown and their slow recovery as occupancy rates at offices only rose slowly. The return of nighttime and weekend activity in the cities though shows where opportunities lie for repositioning.

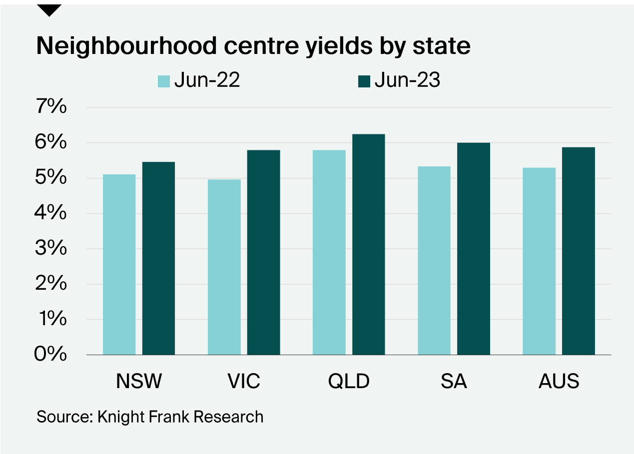
CBD Shopping Centres

	2019 GLA (per store) sqm	2021 GLA (per store) sqm	2022 GLA (per store) sqm	% Change 2019-2022	2019 Gross Rent (exc. market levy) $ psm	2021 Gross Rent (exc. market levy) $ psm	2022 Gross Rent (exc. market levy) $ psm	% Change 2019-2022
Total food retail	86	79	79	-8.14%	3103	3,076	3,423	10.31%
Total food catering	83	89	96	15.66%	2331	2,199	1,927	-17.33%
Total apparel	115	119	129	12.17%	2611	2,437	2,493	-4.52%
Total general retail	95	105	119	25.26%	2598	2,607	2,573	-0.96%
Total non-food specialities	105	100	109	3.81%	2684	2,438	2,419	-9.87%
Total retail speciality shops	93	95	103	10.75%	2517	2,379	2,279	-9.46%

NEIGHBOURHOOD CENTRES

Neighbourhood offers performed strongly over the study period, influenced by localised trade trends driving growth





Neighbourhood stores benefit from shopper trends

A fast growing centre type for investors, the supermarket anchored local centres, has presented limited volatility in MAT performance across the period. Total food catering remained stable and general retail dropped only marginally, reinforcing the underlying strength of supermarket anchored centres. Latest figures indicate the large neighbourhoods have benefited from a level of retained trade even following the cessation of restrictions. The question will be how consumers alter their consumption as regionals and super regionals seek to re-assert themselves with new, improved and an increasingly experiential offer.

Yield rises provide attractive income, while rents remain firm

Yields in these, traditionally neighbourhood centres, have moved out more than in the other categories. The average across Australia is now at 5.9% up from 5.3% a year ago. Given the traditional strong income performance in this offer, they look attractive.

Rents rose strongly across the board as the centres went from strength-to-strength during the pandemic being the go to place during lockdowns. The across the board GLA growth within the centres is reflective of owners seeking to retain additional trade, and also increase the earning capacity as spend levels stabilise and unfavourable economic conditions hopefully ease.

Market Viewpoint—Sid Sharma, HomeCo Daily Needs REIT CEO

The retail landscape has been evolving for a decade. The flight to convenience retail has been accelerated since the pandemic. There is a step change in rental and foot traffic performance for convenient retail assets in neighbourhood and large format retail that are well located in growing metropolitan corridors. It is important to differentiate retail sub-sectors which have very different fundamentals in tenancy composition, architecture and location.

Traditional retail sub sectors such as Super Regional, Regional and sub-regional assets have seen some yield and cap rate softening along with lower trading volumes. This is a function of rental growth softening and the impacts of omnichannel penetration on such categories as fashion.

Convenience retail however which focusses on neighbourhood and large format retail centres remain more resilient. 86% of all consumer spending in Australia is in food and homewares retailing. These categories are focussed on 2 staples in Australian consumption - being food and housing (as our population grows). Having convenient retail assets focussed on these growing tenant bases along with providing essential last mile retail logistics infrastructure mean they are fit for purpose on what the consumer expects in the future. The consumer expects goods and services not only same day but within hours. Well located assets close to homes are the key for this fulfilment.

Neighbourhood Shopping Centres

	2019 GLA (per store) sqm	2021 GLA (per store) sqm	2022 GLA (per store) sqm	% Change 2019-2022	2019 Gross Rent (exc. market levy) $ psm	2021 Gross Rent (exc. market levy)	2022 Gross Rent (exc. market levy)	% Change 2019-2022
Total food retail	129	127	132	2.33%	931	1,062	1,075	15.47%
Total food catering	90	86	90	0.00%	1020	1,196	1,197	17.35%
Total apparel	129	124	122	-5.43%	681	755	807	18.50%
Total general retail	167	139	145	-13.17%	981	1,065	1,108	12.95%
Total non-food specialities	132	94	95	-28.03%	871	1,012	1,025	17.68%
Total retail speciality shops	102	97	99	-2.94%	957	1,072	1,085	13.38%

RECENT SALES

Recent significant sales

CITY	PROPERTY	PRICE $M	GLAR m²	$/SQM	PURCHASER	VENDOR	INITIAL YIELD %[1]
Melbourne	Craigieburn Central	300.0	64,003	4,687	IP Generation	Lendlease	7.71
Melbourne	Broadmeadows Central (50%)	134.5	55,476	4,849	Nikos Property Group	Vicinity Centres	7.04
Melbourne	Sunshine Marketplace (50%)	66.0	34,153	3,865	Aware Super JV Altis	Challenger	6.48
Sydney	Deepwater Plaza	111.0	17,417	6,373	Raptis Investments	Dexus	6.80
Sydney	Stanhope Village	158.0	18,063	8,747	Revelop	Mirvac	5.93
Sydney	Schofields Village	53.0	5,743	9,229	Tony Tran	Coles Group	5.51
Brisbane	Park Ridge Town Centre	86.0	14,314	6,008	Chin Hong Group	RG Property	6.06
Brisbane	Beenleigh Marketplace	85.0	19,823	4,288	Mintus	Dexus	6.99
Brisbane	Dakabin Shopping Centre	40.0	7,409	5,399	Centa Investments	Woolworths	5.22
Adelaide	Brickworks Marketplace	85.0	16,894	5,031	FRP capital	Charter Hall	5.43
Perth	Rockingham SC (50%)	180.0	62,204	5,466	IP Generation	AMP Capital	7.71
Perth	Southlands Boulevarde Shopping Centre	92.5	20,933	4,419	HMC Capital	Lendlease	6.9
Perth	Stockland Riverton	98.8	19,156	5,155	Elanor Investors Group	Stockland	7.76

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

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