RESEARCH

AUGUST 2011

QUEENSLAND RETAIL

Market Overview

Knight Frank

HIGHLIGHTS

- The retailing environment in Queensland, similar to the national position, remains tough with relatively flat retail turnover growth and increasing costs placing pressure on retailers margins and future rental growth levels.
- Sales activity has remained subdued with 17 retail sales above $10 million over the year to July 2011 accounting for $456 million. The syndicate and unlisted funds were dominant purchasers accounting for $227 million, followed by private investors at $117 million. Yields have shown a minor firming trend over the past year, however now faces significant headwinds.
- Retail floor space expansion has continued with approx 280,000m² of floor space under construction across the State, with 40% of this within Regional Queensland. The development pipeline remains strong (410,000m² with Development Approval and 471,301m² in Development Application), although the timing of many projects has been delayed.

RETAIL OVERVIEW

The retail market has been subdued under the weight of flat trading conditions for many retailers and an investment market with limited activity. There have been a number of pressured sales with limited prime opportunities offered to the market.

Household Sector

The household sector has recently shown indications of increasing conservatism as government stimulants applied to the economy have run their course. Figure 1 shows the quarterly gross disposable income for the Australian household sector and the applicable net household savings rate since 2000. This indicates that while household disposable income has continued to increase steadily the net savings patterns of households have changed markedly in response to changing sentiment and economic conditions.

Gross disposable income jumped by 7.5% between the September 2008 and December 2008 quarters, as average variable mortgage rates decreased by 250 basis points and Federal Government Stimulus boosted household finances. Initially this spurred increased savings levels, taking the net household saving above 10% for the first time since late 1986. Within three quarters this extreme conservatism had abated and savings rates fell to between 7-8% during 2009/10 before becoming more conservative again from late 2010. This increased conservatism from Australian households means that despite an increase in disposable income of 22% between the March 2008 and March 2011 quarters, the total increase in retail spending over the same period has lagged at only 11%. Retail turnover growth was relatively flat for the 2010/11 financial year; a modest 2.6% for Australia and 2.0% for Queensland.

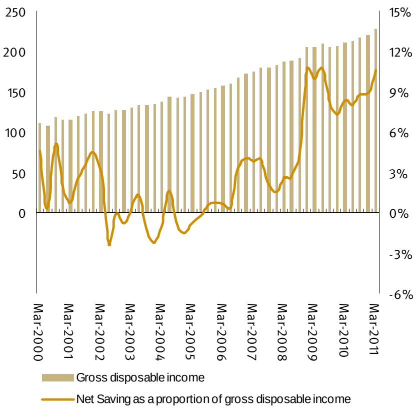
RETAIL SPENDING LAGS DISPOSABLE INCOME GROWTH

This conservatism, despite increased capacity within the economy is linked to low sentiment across both the household and business sectors. Continued speculation regarding the impact of the Carbon Tax and sovereign debt levels in countries such as Spain, Portugal, Greece and Italy has kept sentiment levels subdued. The July figure of 92.8 was an 8% drop from what had been only modest confidence into outright pessimism. Also in Queensland the natural disasters of late 2009/early 2010 have suppressed economic activity, deferred business decisions and suspended export activity, particularly within the coal and other mining sectors.

Figure 1

Australia Household Income & Saving

Disposable Income $b (LHS) & % net saving (RHS)

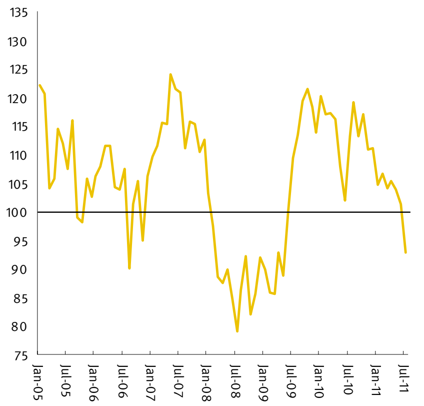


Source: ABS 5206.14 – seasonally adjusted

Figure 2

Australia Consumer Confidence

Index Points 100+ = optimistic



Source: Westpac/Melbourne Institute

Table 1

Queensland Retail Turnover Figures $million June 2011

	Food Retail	Department Stores	Clothing, Footwear & Accessory	Household Goods	Café, Restaurants & Takeaway Food	Other	QLD Total	Australia Total
June 2010	1,726.8	308.4	275.3	717.6	487.0	589.9	4,105.1	20,255.4
June 2011	1,817.1	307.0	295.1	703.3	507.0	610.8	4,240.3	20,540.2
% change	5.2%	-0.5%	7.2%	-2.0%	4.1%	3.5%	3.3%	1.4%
FY 2009/10	20,224.8	3,710.8	3,264.8	8,679.6	5,925.7	7,262.9	49,069.0	239,183.1
FY 2010/11	21,225.7	3,721.4	3,409.8	8,325.3	6,146.9	7,232.1	50,061.3	245,369.4
% change	**4.9%**	**0.3%**	**4.4%**	**-4.1%**	**3.7%**	**-0.4%**	**2.0%**	**2.6%**

Source: ABS 8501.0 Table 12 Seasonally adjusted

BRISBANE CBD

The Brisbane CBD retail market is presently dominated by refurbishment and a number of tenant relocations. The major refurbishment currently underway is the second stage upgrade of the Wintergarden Centre by ISPT. The first stage of 17 retail outlets opened in Q2 2011 with retailers such as Swarkovski (in Myer Centre), Rodd and Gunn (relocated from Queens Plaza) and Wittner (in Queens Plaza) new to the Wintergarden.

After being vacant since the relocation of Dymocks in late 2009, the heritage listed ground and mezzanine retail space within the Macarthur Central building is expected to see refurbishment activity with Apple mooted to have committed to the site.

This was one of two large available spaces within the retail zone of the CBD, the other created by the closure of Borders Books. This tenancy covers three of the four levels (approx 2,200m²) in the refurbished building.

With flagship retailers such as Zara or Top Shop actively considering expansion within the Australian market, the hope would be that as much of the building as possible can be leased in one line, although it is removed from the Brand Name hub at the Edward Street end of the Mall and may struggle to attract Queen Street Mall tenants to the location. Recent or expected closures of retailers such as Colorado and Borders, along with new space coming on line is beginning to have an impact on the amount of available retail space across the CBD.

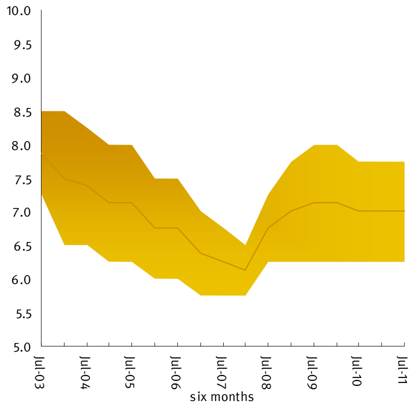
At this stage vacancy is the most obvious within the street front retail along Adelaide, Edward and Elizabeth Sts; as prime Mall Front opportunities remain highly sought, and competed for. This has prompted tenant remixing ie Queens Plaza has new tenants Chanel and Sass & Bide with Mimco and Witchery relocating within the centre. In addition there are now a number of new tenants emerging in Edward Street.

ISPT has increased its investment in the Brisbane CBD through major refurbishment and purchasing activity over the past 12 months, both of which are concentrated towards the Edward Street end of the Queen Street Mall. In addition to the $80 million refurbishment of the Wintergarden Centre, the recent $62.5 million purchase of Broadway on the Mall is the largest investment in CBD retail property since the Precision Group paid $120 million for Macarthur Central in 2006.

REFURBISHMENT AND TENANT RELOCATIONS DOMINATE

The purchase of Broadway on the Mall, located opposite the Wintergarden across the Queen Street Mall, was transacted on a core market yield of 7.85% (passing yield circa 6.65%) and is considered strategic with the current configuration of the centre requiring some tweaking to maximise potential, particularly on the upper and below ground levels.

Figure 3
Brisbane CBD Retail Centre yield range
Core Market Yield



Source: Knight Frank

Yields for prime CBD retailing assets have remained relatively stable over the past 12 months, with some minor firming continuing in line with the wider market. Ranging from 6.25% - 7.75% the analysed market yields represent gradual firming across the upper yield range over the past year. However properties which are underperforming or have vacancies will continue to be punished in the current environment.

Further wholesale firming will be hampered by the current expectation that significant market rental growth will be difficult to achieve in the medium term. Queen Street Mall rates have stabilised between $6,000 – $8,000/m² gross (depending on shop size) with second tier locations $1,000 - $5,000/m² gross and internal space or street frontages outside the retail hub $600 - $1,000/m² gross. Following the re-introduction of convenience retailing into the major CBD centres over the past five years, the focus is now firmly on attracting more high-end international brand tenants.

Table 2
Brisbane CBD Retail Property Sales >$10 million 2010 + 2011 ytd

Address	Price $ m	GLAR m²	Core Market Yield %	Major/s	Purchaser	Vendor	Date
Broadway on the Mall	62.50	7,389	7.85	Harvey Norman + 70 specialty	ISPT	Private Investor	May 11
Eagle St Pier	16.00*	6,276	7.00	Restaurants	Future Fund	SDOT 1	May 11

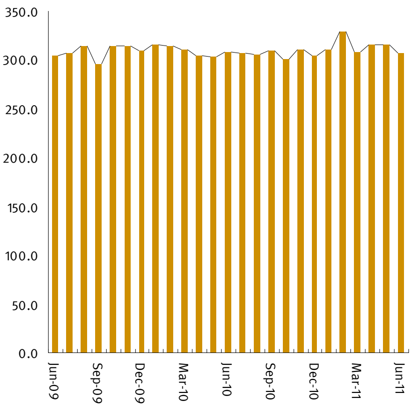
Source: Knight Frank * represents a 50% sale of the retail component of the asset which also included Waterfront Place office tower

REGIONAL & SUB-REGIONAL CENTRES

The majority of regional and sub-regional centres across Queensland have maintained high occupancy levels. However a recent increase in the receivership and closing of high profile retailers has begun to create vacancies. Brands such as Colorado, Mathers, Williams, Angus & Robertson, Borders, Kenny's Cardiology and Ed Hardy have or are in the process of closing some if not all retail stores due to receivership. Additionally large retail groups like Just Group are flagging their intention to close loss making stores unless rental levels can be moderated. The larger former book stores have been mooted as prime opportunities for expanding retailers such as Zara, Top Shop or Lincraft. Vacancies are increasing, however new retailers such as Blue Illusion or Matchbox continue to emerge to fill the gaps.

With regional and sub-regional centres largely underpinned by discretionary spending, the cautious nature of consumers has been felt within this sector. Department Stores have experienced two years of flat trading conditions where consumers have become increasingly conditioned to sales and a discounting environment. Queensland Department Store turnover for FY 2010/11 was $3.721 billion, growth of 0.3% over the previous year, and only 0.1% ahead of 2008/09. This and profit downgrades from David Jones indicates that in their current format department stores are not capturing the consumer's interest.

Figure 4
Queensland Retail Turnover
Department Stores - $ million



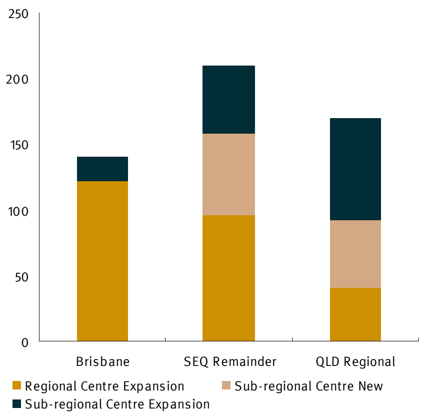
Source: ABS 8502.12 seasonally adjusted

Similarly the retail turnover results for the Clothing, Footwear and Personal Accessories sector of the market have also only been moderate with growth of 4.4% for the FY 2010/11.

Larger retail centres such as regional and sub-regional centres have continued to broaden their offering with greater emphasis on the relatively less volatile fresh food/grocery and café/dining/entertainment elements. This is in order to both increase the frequency of visits and the breadth of activities that draw consumers to visit. The continued introduction of new brand names and potentially embracing pop-up stores may also keep the offering fresh.

Despite the relatively flat trading conditions (Westfield reports national comparable retail sales growth of -0.7% in the March 2011 quarter and no change over the year to March 11) many of the largest Queensland retail centres are advancing expansion and refurbishment plans. Westfield has an expansion of approx 31,000m² underway at Carindale and there are advanced plans for expansions at Chermside, North Lakes and Garden Square. Indooroopilly Shopping Centre also has approval for a 24,000m² expansion/town centre. In Townsville, Stockland is working on a major expansion to the Stockland Townsville Centre which will take the centre to regional status on completion in 2012.

Figure 5
Regional & Sub-Regional Development
Proposed Additional Floorspace '000m²



Source: Cordell Connect/Knight Frank

Table 3
Queensland Regional & Sub-Regional Centre Sales 2010 & 2011 ytd

Address	Price $ m	GLAR m²	Core Market Yield %	Major/s	Purchaser	Vendor	Date
Centro Hervey Bay	65.0	15,569	7.50	Target, Super IGA + 40 specialties	Stockland Trust	Centro Aust. Wholesale Fund & Leda Holdings	Mar 11
Circle on Caville, 3184 Gold Coast Hwy, Surfers Paradise *	40.0	8,757 (+3,573m² office)	10.25	IGA, Strike Bowling + 26 specialties	EG Funds Management	Mortgagee in Possession	Dec 10
Orchid Ave & Gold Coast Hwy, Surfers Paradise *	42.0	8,286#	9.00	54 specialties	EG Funds Management	Cromwell Group	Oct 10

Source: Knight Frank *tourist based retail centres #includes an office component, 20 residential units are not included in the GLA

NEIGHBOURHOOD CENTRES

Neighbourhood centres, underpinned by the stability of the grocery market, have remained stable investments. Food retail sales have grown by 4.9% in Queensland for the year to June 2011, the highest of any of the retail sectors. While this steady growth is likely to reflect price increases (Food CPI grew 6.1% to June 11) as much as consumer behaviour, the inelastic nature of grocery retailing underpins the stability of the sector. For supermarket and specialty retailers margins are low and market rental rates for specialty stores have stabilised at \$500 – 650/m² gross.

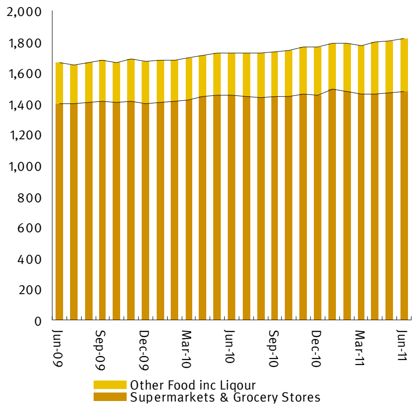
At this stage Coles is achieving better comparable store turnover (6.3% versus Woolworths 3.0% for 2010/11), but both continue to pursue new developments. Additionally IGA is seeking trading opportunities across the state. While many developments have been deferred (approx 64,000m² of potential neighbourhood floorspace being tracked by Knight Frank) there is still some 56,000m² currently under construction. The majority of this activity is outside the South East corner of the state with the focus on regional Queensland and the major grocery retailers seeking to capture the upside from mining related growth. In a number of situations either Coles or Woolworths have stepped in to develop a project they had previously committed to as a tenant, ensuring its timely completion.

Sales activity remained sporadic with private investors dominating the purchaser profile. Over the 12 months to July 2011 there were only five neighbourhood sales with yields largely stable over a range of 7.50% - 8.75%.

Figure 6

Queensland Retail Turnover

Food Retailing $ million

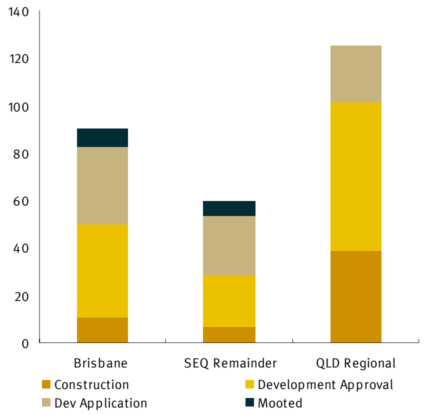


Source: ABS 8502.12 seasonally adjusted

Figure 7

Neighbourhood Centre Development

'000m² Proposed Additional Floorspace

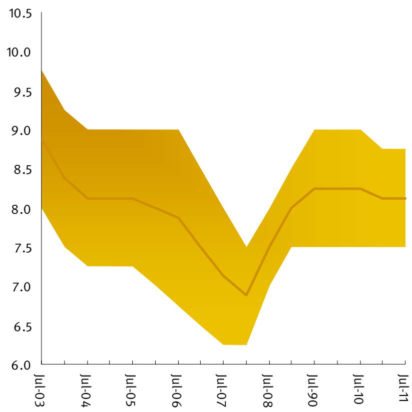


Source: Cordell Connect/Knight Frank

Figure 8

Queensland Neighbourhood Centres

Core Market Yield (%)



Source: Knight Frank

Table 4

Queensland Neighbourhood Centre Sales >\$10 million 2010 & 2011 ytd

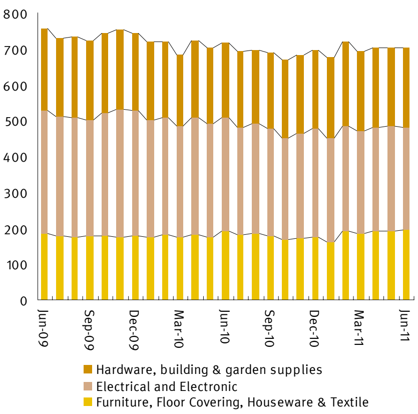
Address	Price \$ m	GLAR m²	Core Market Yield %	Major/s	Purchaser	Vendor	Date
146 Blunder Rd, Oxley	20.68	7,379	10.00^	Aldi + Oxley Tavern +15 specialty	Private Investor	Lend Lease Funds Mgt	Jun 11
Marsden Park, 57 Chambers Flat Rd, Marsden	35.15	8,222	8.17	Coles + 37 specialties	Private Syndicate	Private Investor	Mar 11
Crestwood Plaza, 458 Olsen Av, Molendinar	12.80	3,000	8.15	Supa IGA + 16 specialties	Prime Space Projects	Private Investor	Dec 10
96 Coonan St, Indooroopilly	12.64	4,463	8.55	Coles + 10 specialties	Cassimatis Family	FKP	Dec 10
Bluewater Square, 20 Anzac Ave, Redcliffe*	47.80	11,360	8.88	Woolworths + liquor barn + gym + 30 specialties	Bluewater Syndicate Pty Ltd	Anthony John Group	Aug 10
Village Fair, 3358 Mt Lindsay Hwy, Regents Park	17.50	4,683	8.86	Supa IGA + 26 specialties	Private Investor	Premier Pacific	Feb 10

Source: Knight Frank *vendor & purchaser understood to be related parties ^passing yield

BULKY GOODS CENTRES

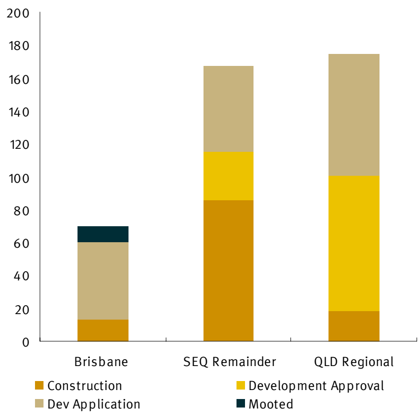
The bulky goods sector has remained subdued over the past 18 months with stagnating retail sales. In part, price deflation of imported electronic items due to the stronger $AUD has played a part; however the retailing environment remains tough. Household goods sales are down -4.1% for the FY 2010/11 with most of this weakness coming from electronic goods (-10.9%). The lack of an iconic new electronic (non-Apple) release has limited the buzz surrounding electronic products this year.

Figure 9
Queensland Retail Turnover
Household Goods $ millions



Source: ABS 8502.12 seasonally adjusted

Figure 10
Bulky Goods Centre Development
'000m² Proposed Additional Floorspace

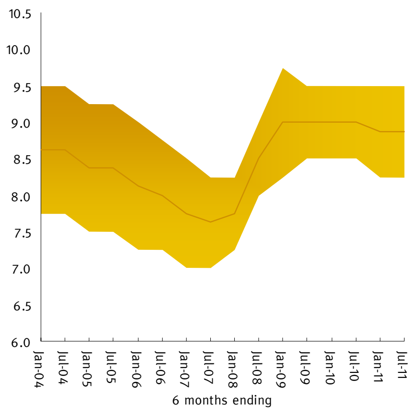


Source: Cordell Connect/Knight Frank

This tough retailing environment, combined with rental levels reaching the limit of affordability for retailers in 2009/10 ($220 - $300/m² net) has impacted on the investment climate for the sector. Despite this, development is continuing, tied to pockets of population and wealth growth. Additionally the introduction of new player, the Woolworths backed Masters chain, has spurred additional development across the metropolitan Brisbane and regional areas.

Masters is expected to launch nationwide in Q3 2011 with five Queensland stores either under construction or completed and a further four with either development application or approval. In response, Bunnings has also ramped up its development program with one warehouse under construction and a further six in the pipeline. Outside of this direct investment through brand expansion, sales activity in the sector has remained slow. A mooted 50% sale of the 8,291m² Domain Central in Townsville for circa $50 million would be the most significant sale of 2011.

Figure 11
Queensland Bulky Goods Centres
Core Market Yield (%)



Source: Knight Frank

Table 5
Queensland Bulky Goods Retail Sales >$10 million 2010 & 2011 ytd

Address	Price $ m	GLAR m²	Core Market Yield %	Major/s	Purchaser	Vendor	Date
Morayfield Supa Centre, Morayfield Rd, Morayfield	38.50	24,248	9.25	Spotlight, Beacon Lighting, Sleep City	Kilcor Property Holdings	Mirvac REIT	Jun 10
1836-1840 Sandgate Rd, Virginia	14.50	14,523	7.93 ^	Officeworks, Campbells	Bunnings Properties	Opus Property Trust No.11	Jan 11
544 Kessels Rd, Upper Mt Gravatt	13.10	8,291	9.10	JB Hi-Fi, Bob Jane T Mart, AP Eagers	Private Investor	PFA Diversified Property Trust	Nov 10
Lot 63 Prospect St, North Lakes	12.29	39,900~	Site	-	Woolworths (Masters)	Stockland Trust	Apr 11
Freedom Homemaker Centre, 67 Redland Bay Rd, Capalaba	11.97	5,729	9.50	Freedom Furniture, Beacon Lighting	Private Investor	Becton Funds Mgt	Jan 10
Noosa Gateway Centre, 1 Gateway Dr, Noosa Heads	10.80	4,414	8.82	Officeworks	RP Trust	Private Investor	Feb 10

Source: Knight Frank ~ site area ^passing yield

OUTLOOK

The retailing environment has been receiving much public attention of late, with retailers decrying spending leakage to overseas e-retailers, high occupancy and operating costs and subdued consumer activity. As outlined above the household sector has markedly changed their patterns over the past six months with saving levels back to those seen during the worst of the GFC. Despite this the only retail sectors which have experienced lower levels of sales turnover (comparing FY 2010/11 with 2009/10) in Queensland are the Household Goods sector (-4.1%) and the Other sector which includes books or newspapers, cosmetics, and recreational goods (-0.4%). However with the remaining sectors recording growth in the range of 0.3% - 4.9% and the total retail turnover up 2.0% in Queensland, retailers are struggling to maintain margins. To keep this in context, however, this softening of the past two years has come after an extremely strong run for retailers with the average annual turnover growth for the previous five years a healthy 5.7% p.a.

Despite the negative commentary and sluggish turnover figures some retailers such as Apple and Zara have continued to capture the interest and spending power of consumers. Both brands provide access to global products which have been able to develop the desire to possess, generally before the relevant products or season ranges are released. Thus while local retailers are undoubtedly feeling the effects of a more conservative consumer, they also must consider the potential that their current ranges and methods are not engendering a desire to spend within their target audiences. The offerings from Australian retailers may be found wanting in comparison with goods seen/available from internationally based retailers. Saving can be a fickle discipline in the face of an overwhelming desire to possess an object and largely this desire is not being triggered.

Another major diversion for household spending is travel and the numbers of Australians travelling overseas reached a record level of 689,800 persons in April 2011 (ABS 3401.0). This was not a one-off with the May 2011 figure of 649,400 12.6% higher than for May 2010. With the Australian dollar remaining at historically high levels to date, this has encouraged extensive travel (and likely extensive shopping) in international locations.

MARKET RENTS HAVE STABILISED

Thus both retailers and owners of retail property, particularly in the discretionary bulky goods, sub-regional, regional and CBD sectors need to address these consumer behaviour changes. Increasingly for bigger ticket items consumers are using the physical stores for 'fact finding missions' and will then price compare across a variety of sources once a preferred product is identified. Turning these enquiries into sales is now the main hurdle for retailers with multiple brands. For non-franchised single brand stores – ie Sony Shop or Apple the decision by consumers whether to purchase in store or on-line is irrelevant as there is no revenue leakage once the decision to buy is made. For all other retailers conversion on the spot becomes a greater issue.

Landlords must explore what refurbishments or remixing of tenants can be undertaken to improve centres' performance. In terms of re-design the planning limitations for bulky goods centres will place greater hurdles than for the larger suburban or CBD centres, however the current trends are to increase the restaurant/entertainment component and also to draw back the daily/weekly shop for fresh food. This is designed to increase both the frequency of visits and breadth of activities undertaken on site. Loyalty programs may also be trialled although the appetite for retailers to fund these programmes is currently limited.

Most retail market rental levels have stabilised over the past two years with retailer appetite to pay ever-increasing market rents diminishing. It is not uncommon for the rental levels for sitting tenants to reduce at market review as the structured rental growth within the lease has not been in line with recent market movements. Initially this phenomenon was mainly seen in larger centres and new neighbourhood centres where the rental levels were set at unrealistic levels for pre-sales, however this is now a more general market phenomenon. In general, however the structured reviews of leases provides for steady income growth from retail assets year on year.

Yield contraction within this environment is expected to be modest with some firming over the past 18 months aligned with general market recovery. While retail yields have softened since the market peak of 2007, this sector did not feel the effects in terms of yield softening as did the commercial and industrial sectors, due to the relatively less volatile income streams and lower vacancy levels prevalent in the Australian retail market. Therefore the firming trend for retail yields will be muted as well.

As the AUD has appreciated over the past two years, consumers have come to the realisation that the exchange rate did not totally account for the differences in shelf prices for goods between Australia and other major retail markets. This disenchantment has led to greater creativity in sourcing products from online retailers (either in Australia or overseas) just as that platform reached a new level of sophistication. This has broadened the 'retail market' far beyond the retail centres we are familiar with, engendering uncertainty across traditional players. A positive factor is that the household disposable income levels have continued to grow, meaning that the spending power is there, just currently redirected. Given the level of investment and market intelligence within the sector there is no doubt that landlords and retailers will combat these recent trends.

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