Australia Retail - November 2023

MARKET IN MINUTES

Savills Research

Retail Investment

Rate stability to set tone for gradual recovery

Investment activity subdued
Total investment volumes ($10m+) reached c.$876 million in Q3. This is an improvement on the previous quarter (c.$637m), however represents a 44% drop on the same period last year.

Bid-to-ask disparity remains
The gap between buyer and vendor expectations continues to weigh on activity, particularly for larger deals as select institutional investors opt to wait out this phase of the cycle.

The surge in bond yields is presenting further challenges, and there is still some volatility in economic data, particularly services inflation, which suggests that this correction cycle has further to run.

Capital markets adjust as privates and syndicates step up
While the market continues to adapt to the rapidly evolving economic environment, investors on the whole retain strong interest in the sector and the fundamentals support long-term growth.

There has been a less dramatic shift in retail valuations to date, relative to the other commercial sectors, given the sector underwent a large proportion of its pricing correction during 2020.

On the buy side, private capital remains the most active. This coincides with the sustained demand for neighbourhood and large format assets. For the assets that have traded in Q3-23, private and syndicate capital played the most significant role, representing 57% (c.$500 million) of the total volume.

Outlook for 2024
The RBA raised the official cash rate by 25 basis points to 4.35% at its 7 November 2023 meeting. Although there are very early indications that another hike is being partially priced in for February 2024, the RBA statement signalled hopes this would not be the case.

This is echoed in the market pricing, which leans towards the official cash rate remaining on hold for most of 2024, with most economists still expecting a pivot to cut rates in late 2024. Interest rate stability and further pricing adjustment will reduce the gap between buyer and seller expectations and help fuel a recovery in investment market activity next year. We expect investment activity is likely to gain momentum slowly in 2024, with ongoing subdued activity in the first half of the year and the recovery gaining more traction later in the year and into 2025.

Latest economic indicators

	Latest Date	Current	Trend
GDP*	Jun-23	2.1%	▲
Monthly CPI Indicator*	Sep-23	5.6%	▲
RBA Cash Rate Target	Nov-23	4.35%	▲
Unemployment Rate	Sep-23	3.6%	◀▶
Retail Trade*	Sep-23	2.0%	▲

Source Savills Research / ABS / RBA
*asterick denotes annual rate, otherwise rate reflects monthly figure

$35.9bn
retail spend
Sep-2023*
(ABS)

1.47m
persons employed
in retail trade
Jun-2023*
(ABS)

$876m
transaction
volumes ($10M+)
by value in
Q3-2023 (Savills)

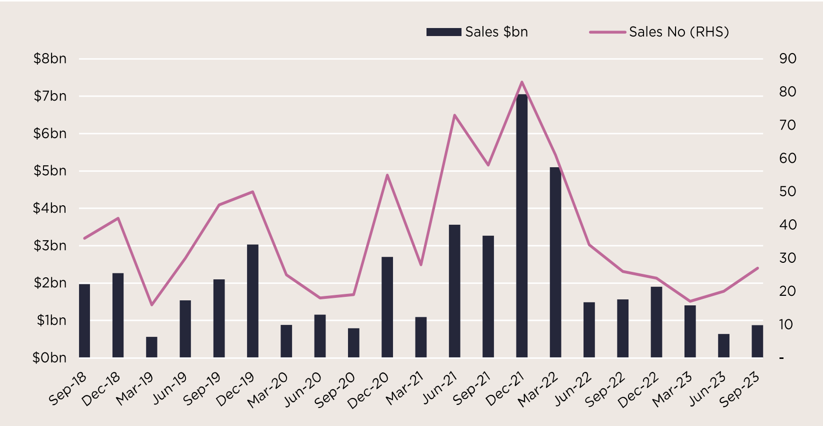
5.6%
Monthly CPI
indicator
(12mo to Sep-23)
(ABS)

Source Savills Research / ABS
*Seasonally adjusted terms

Quarter highlights

Investment volumes subdued

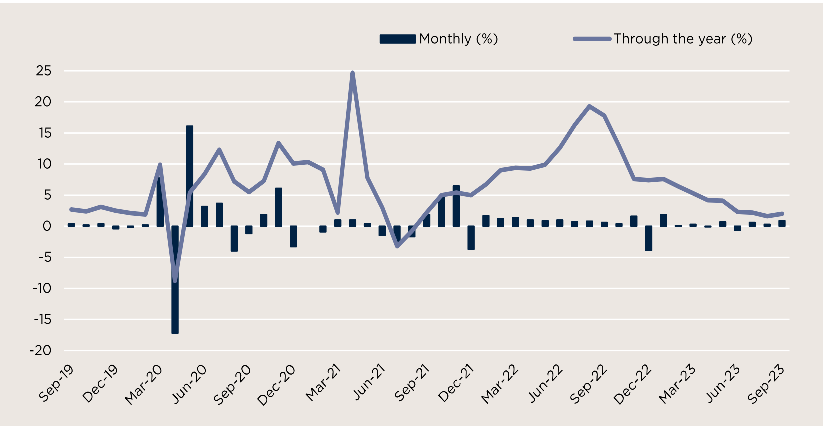
Transaction volumes ($10M+) vs number of sales, quarterly to September 2023



Source Savills Research

Retail sales rose 0.9% in September, up 2.0% annually

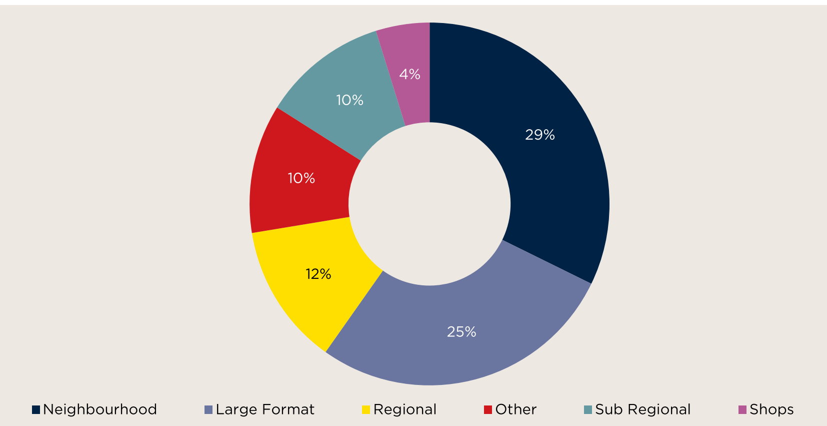
Retail trade, monthly turnover v through the year, seasonally adjusted (%)



Source Savills Research / ABS

Share of investment volumes by centre type

% share of investment volumes ($10m+) by centre type, 3-months to September 2023



*other includes freestanding, mixed use
Source Savills Research

Grocery demand resilient
Neighbourhood transactions ($10m+) held the largest share of total investment volumes (by value) for the second consecutive quarter, accounting for 34%, above its historical average of 23%. Non-discretionary retail remains robust, sustaining investor interest throughout this cycle. However, activity across the board is constrained by a shortage of on-market opportunities.

Recent sales include Woolworths selling a neighbourhood centre in Bomaderry (NSW South Coast) to a private investor for $40 million on a reported yield of 5.43%. Additionally, a private investor offloaded Poinciana Place Shopping Centre (Noosa, Qld) to a local family for $17.5 million.

Nominal sales lift, distorted by inflation and promotions
Retail sales, in nominal terms, lifted 0.9% in September, taking the annual rate of growth to 2.0%. By category, food retailing trended higher, up 1.0% m/m (+3.5% Y/Y). Cafes, restaurants and takeaway food spending growth was unchanged over the month, however had the strongest annual growth of 6.1%. Surprisingly, there were gains in department stores (+1.7%), and household goods retailing (+1.5%), with the ABS noting that the release of the new iPhone model and a climate energy rebate in Qld provided a boost to household goods retailing. Notably, household goods retailing remains 4.0% lower than a year ago.

When you disentangle the temporary factors, trend retail trade only rose 0.3% in September and 1.5% through the year. This reflects a sizeable decline from the 17.8% annual growth rate recorded in September last year and suggests growth is more to do with price inflation, than increased spending.

With pre-Christmas spending tipped to be in line with last years trade, further growth in spending is expected in the short term. In the lead up to the busy holiday period, additional promotions, including Black Friday, Click Frenzy and Cyber Monday will contribute to this activity. Australian's spent an estimated $7.1 billion across the four days in 2022, according to NAB.

Low vacancy enhancing income return
Several retail centre landlords reported positive income growth in FY23 and re-leasing spreads, however noted that retail trade volumes had moderated, particularly for discretionary spending categories.

There continues to be positive rental reversions due to fixed and CPI-linked reviews, and this is helping to offset negative valuations. Recent examples include Newmark Property REIT reporting that their large format retail income was up 3.4% Y/Y, and vacancy was at a historic low (3.5%). Charter Hall reported 98.6% occupancy across the retail portfolio in FY2023, with positive specialty re-leasing spreads at +2.5%, up from 2.3% in FY2022. While Vicinity reported large national retailers are more willing to commit to long-term leases, with the group transitioning over 200 stores from short-term to long-term leases.

On the funds side, a comparatively solid income growth profile for retail has helped offset negative capital growth across all other sectors. The total return for all funds covered by the MSCI/Mercer Australia Core Wholesale Monthly Property Fund Index has fallen to -4.4% in September 2023, compared to total returns in retail for the year at -0.6%. Income return for retail funds in the Index achieved +4.9%, above the weighted average for all funds over the same period (+4.0%). The MSCI index covers 15 funds, including office, retail, industrial and diversified funds, managed by GPT Group, Charter Hall, ISPT, Mirvac, QIC, Dexus, AMP Capital, Lendlease and Investa.

KEY TRANSACTIONS

Sales ($10m+)

Property	Centre Type	Price ($m) | Date | GLA	Yield (%) | Type | $/sqm
Townsville Shopping Mall, QLD (50%)	Regional	115.0 | Sep-23 | 44,908	7.95 | e | 4,943
Settlement City, NSW	Sub Regional	102.4 | Jul-23 | 19,563	7.04 | e | 5,234
HomeCo Midland, WA	Large Format	74.8 | Aug-23 | 23,410	6.89 | e | 3,193
Bunnings Collingwood, VIC	Large Format	63.5 | Jul-23 | 7,745	4.91 | e | 8,199
Cobblebank Village, VIC	Neighbourhood	46.5* | Jul-23 | 6,325	5.30 | r | 7,352
Rothwell Shopping Centre, QLD	Large Format	41.0 | Jul-23 | 11,015	6.76 | e | 3,722
Woolworths Bomaderry, NSW	Neighbourhood	40.0 | Sep-23 | 5,451	5.32 | e | 7,338

Source Savills Research / MSCI Real Capital Analytics; i = Initial, e = Equated, r = Reported; *Approximate

OUTLOOK

Economic challenges but population growth supports spending
Elevated interest rates and the strains of rising living costs have significantly dampened sentiment, causing consumers to curtail their non-essential expenditures. Conversely, labour market conditions remain exceptionally tight when viewed through historical standards, with the unemployment rate near multi-decade lows, contributing to higher wage growth. While this, coupled with the resurgence in population growth and tourism, will support to consumer spending, ongoing high inflation and the increase in mortgage costs will continue to weigh on household consumption.

Higher oil prices and geopolitical risks
Geopolitical risks have increased recently, with the breakout of the Israel-Hamas conflict. An escalation of conflict could potentially drive oil prices higher and present upside risk to inflation, although higher oil prices will also weigh on global recovery.

Bond yields surge
With major central banks at or very near the end of the tightening cycle, bond markets have become increasingly volatile as financial markets struggle to price the probability of interest cuts in 2024. Economists generally expect several cuts towards the end of next year, with a median expectation that the cash rate will be 3.85% by the end of 2024. However, market pricing suggests the cash rate will remain on hold throughout next year.

Period price discovery still running
Some transactions have been put on hold for re-evaluation in 2024, resulting in a probable continued decline in year-end transaction volumes, especially with investors preferring a cautious “wait-and-see” strategy. At this stage in the cycle, prices have not yet adjusted enough to restore deal activity to long-term levels, and we are seeing this come through in the return profiles as yields continue to expand. The trend suggests that the period of price discovery still has further to run. Although the cost of debt remains a barrier for certain deals, investor capital is poised to act swiftly when opportunities arise, capitalising on reduced competition.

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