m3 Dimensions

Retail Rents Revival while Retail Sales Slow

March 2005

The weakness in retail trade figures has been the widely reported over the past six months. Following the rise in official interest rates by the Reserve Bank earlier this month, growth in consumer spending is expected to remain more subdued than in recent years over the short term, placing the attractiveness of retail property as an investment under question. However, we expect that the recently subdued rental growth is set for a catch up, despite the likelihood of continued weakness in sales growth.

According to the Australian Bureau of Statistics (ABS), the annual growth in retail trade has fallen dramatically over the past six months. The following chart shows that, in trend terms, retail trade growth has recorded its largest slump in eight years.

Source: ABS, Retail Trade Cat No. 8501.0, Table 1; **m3** property

There have been numerous positive influences on consumer spending, such as:

- low unemployment,
- government assistance in the form of family payments and tax cuts,
- cheaper imports as a result of the high local currency, and
- strong consumer confidence.

Despite the positive environment, the annual change in retail trade has fallen from 9.04% in July 2004 to just 1.38% in January 2005.

Retail spending is believed to have come under pressure due to the negative impacts of the downturn in the housing sector which has reduced wealth effects, slowed demand for household goods and increased savings rates (the latter is also a result of interest rate uncertainty). High petrol prices are also believed to have played a part.

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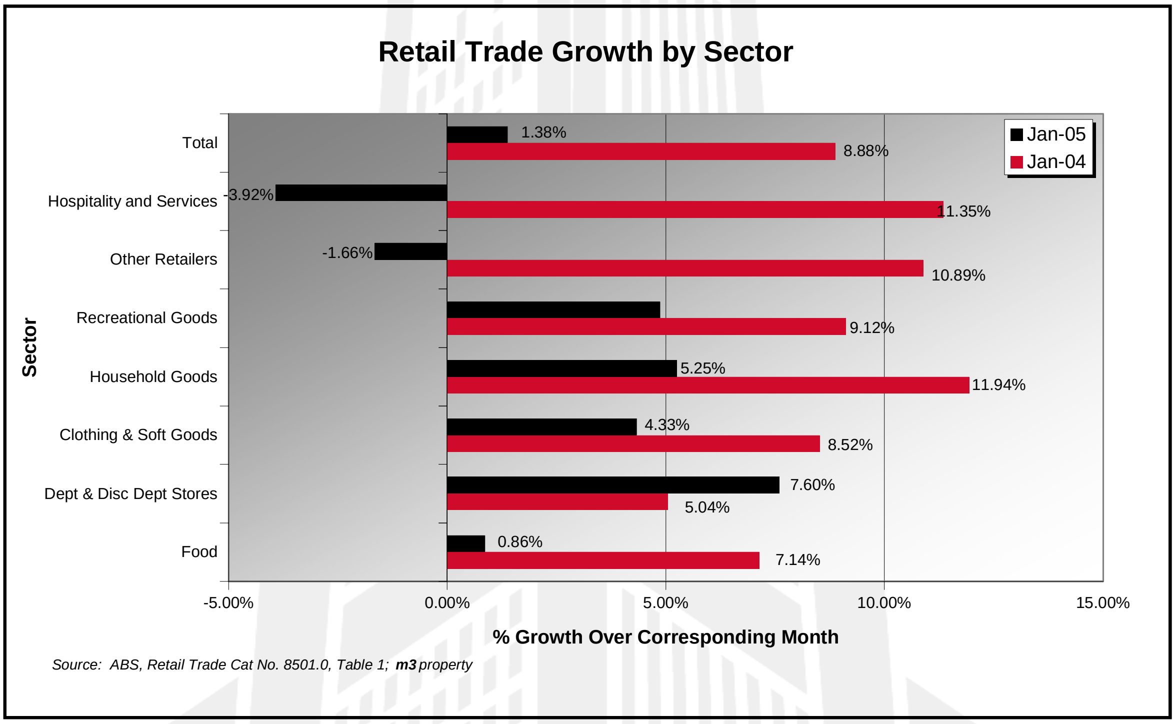
As the chart below shows, the growth in retail trade has fallen in every consumer spending category over the past year, except department and discount department stores (in seasonally adjusted terms).



Despite the level of specialty retail sales over the past six years, this has not translated into strong rental growth. Expectations have been that the increase in specialty Moving Annual Turnover (MAT) would be a catalyst for an increase in specialty rental levels.

To reinforce this point, over the last three to four years specialty Gross Occupancy Costs (GOC) have been falling consistently across all retail centre classes. This is a reflection of higher MAT growth compared with the relatively low rental growth levels associated with specialty retailers.

We anticipate that despite the forecast decrease in retail sales growth moving forward, it is likely that there will be a "catch up" in rental levels. The ability for sustained rental growth is achievable in the context of recent reductions in GOC levels which have seen retailers receiving the benefit of robust consumer expenditure. However, this forecast is predicated on the notion that retail sales growth, albeit modest, remains. While considered highly unlikely due to strong underlying fundamentals, if sales do suffer a dramatic and sustained decline in real terms the prospects for stronger growth in rental levels would be limited.

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