m3commentary

National Large Format Retail

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DEFINITIONS

Large Format Retail Centres: Medium to large shopping centres, dominated by bulky goods retailers such as furniture, electrical, outdoor, white goods. Centres typically contain a small number of specialty shops.

Freestanding stores: Large format retailer in a stand alone store.

LARGE FORMAT RETAIL EVOLVING

- Household goods retail turnover continued to grow over the year to March 2018, supported by ongoing population growth, dwelling completions and low interest rates. The rate of growth has remained stable compared to the year prior.
- Consumer Sentiment as measured by the Westpac Melbourne Institute remains positive as at April 2018.
- Supply of large format retail space continues to be dominated by freestanding stores, however, many centres are reconfiguring to accommodate both downsizing tenants and new tenants within their centres.
- Vacancy rates for large format retail space varied by state over the year to June 2018. Contracting demand from hardware and manchester retailers, in particular, saw vacancy rise in Western Australia (WA) and Queensland (QLD), driving the national rate up, despite the remaining states recording stable or falling vacancy over the year.
- Large format retail centre rents rose slightly over the year to June 2018.
- Investor demand for large format retail has generally remained positive over the year to March 2018. This has resulted in sales activity increasing by 9.4% over the year to March 2018, compared to the year prior.
- Yields across prime Large Format Retail centres continued to tighten over the year to June 2018.

MARKET OVERVIEW

Similar to shopping centres, the large format retail sector is evolving on the back of changing consumer preferences, increased competition and planning changes. This is resulting in a changing retail mix and the growth of lifestyle centres. This is helping drive continued demand for space and falling vacancy in most states and keeping vacancy from blowing out further in Queensland and WA.

This **m3**property report focuses on retailer and investment activity in large format retail properties across Australia. Large format retail comprises multi-tenanted centres (formerly known as bulky goods centres) and single tenanted freestanding stores (occupied by tenants such as Bunnings, Officeworks and Harvey Norman).

The key influences on tenant demand have shown mixed results over recent years. Residential development approvals and construction activity slowed, wages growth remained low and savings rates remained high. However, population and household goods retail trade continued to grow. Planning reforms and consumer preference for convenience and value have changed demand for large format retail space with new retailers including supermarkets and discount retailers increasing take-up.

Overall vacancy rose over the year to June 2018 for large format retail in Australia, while it fell in SA and Victoria and stabilised in NSW, it rose in WA and Queensland.

Positive rental growth has been recorded for large format retail centres in Australia over the year to June 2018 driven by growth in New South Wales (NSW), Victoria and South Australia (SA).

Investment activity remained solid over the 12-months to March 2018. Sales activity, over the $5,000,000 threshold, totalled $1,755,851,000 over the year, increasing by 9.4% compared to the year prior. Transaction demand remains positive due to low interest rates and good sales performance in many markets. Yields firmed over the year to June 2018 across the capital cities.

Ownership of large format retail centres has become increasingly concentrated following the exit of many institutional investors from the sector. Some of the larger centre owners include Aventus, Harvey Norman, Arkadia, Charter Hall, Sentinel, Primewest, Lancini Property & Development and BWP.

m3property Valuations:
Left: Hollywood Bulky Goods, 155 Winzor St, Salisbury Downs, SA. Top: David Witton Drive, Noarlunga Centre. Lower: Amart Furniture, Wendouree (Ballarat) VIC.

KEY INFLUENCES

ECONOMY

The Australian economy's transition away from growth driven by investment in the mining and resources sector, towards other sectors, such as property, tourism and education continues to gather speed. Growth continues to improve in states like NSW, Victoria and SA and while challenges remain, conditions in parts of WA, Queensland and Northern Territory (NT) are also starting to improve. According to the Australian Treasury Budget Papers, in real terms Gross Domestic Product is forecast to grow by 3.00% in 2018-19 and the next three financial years.

CONSUMER CONFIDENCE

The Westpac-Melbourne Institute Index of Consumer Sentiment was positive at 102.4 in April 2018, despite falling 0.6% compared to March 2018. The index remains above a net balance of 100 meaning optimists still outweigh pessimists. The decrease reported in the April survey is likely to be a result of concerns regarding the outlook for household finances and the labour market. We note that the April survey was completed prior to the 2018 Budget hence this is likely to influence the May results.

RETAIL BUILDING ACTIVITY

Nationally over the past year building approvals were largely stable on a rolling annual basis with a slight decrease of 0.5% recorded over the 12 months to March 2018 in comparison to the year prior. Retail development activity is expected to remain robust in the short-term due to approvals from 2017, which are still to be actioned.

POPULATION

Moderate population growth continues to underpin the retail sector despite volatile consumer sentiment and low wages growth. Australia's Estimated Resident Population as at 30 September 2017 was 24,702,900 people reflecting an annual increase of 395,600 (1.6%). The largest population growth in the year to September 2017 was Victoria (2.4%), followed by ACT (1.8%), Queensland (1.7%) and NSW (1.6%).

HOUSEHOLD GOODS RETAIL TURNOVER

Annual rolling household goods retail turnover rose 2.3% over the year to March 2018, supported by ongoing population growth, dwelling completions and low interest rates. The rate of growth was stable compared to the year prior. Turnover rose for all sub groups with hardware, building and garden supplies retailing rising by 1.0%, the furniture, floor coverings, houseware and textile goods retailing rising by 3.3% and Electrical and electronic goods retailing increasing by 2.9%.

The weaker Australian dollar has increased import prices and pressure on profit margins in the sector. It has, however, also dampened imports including those purchased online.

The combination of more households and positive domestic retail spending bodes well for the large format retail sector in the short-term. Increased price competition in the retail industry generally presents an opportunity for the large format retail sector given the industry's low rent/low cost business model which can enable greater savings to consumers.

OCCUPIER DEMAND

MAJOR TENANTS

There are a number of groups, which influence demand for large format retail space. This section looks at the reported plans and performance of some of these retail groups.

WESFARMERS

Bunnings and Officeworks achieved strong comparable sales growth of 7.7% and 7.2%, respectively, over the March quarter 2018.

The Bunnings network consisted of 291 stores in April 2018. According to Wesfarmers, Bunnings had 17 sites under construction at March 2018 including six former Masters stores.

Officeworks had a network of 166 stores across Australia as at April 2018. This represents a net increase of three stores over the year to April.

SUPER RETAIL GROUP

The Super Retail Group (SRG) includes Rebel, BCF (Boating Camping Fishing), Macpac (Rays) and Supercheap Auto. While some of these retailer's stores are freestanding, many are located within large format retail centres.

Supercheap Auto witnessed solid comparable sales growth of 4.4% over the March quarter 2018 and had 275 Australian stores as at April 2018. The 5-year plan is to increase total stores by 26.

Rebel saw like-for-like sales growth of 2.2% over the March quarter. After rebranding the Amart Sports stores to Rebel, there were 158 stores in April 2018. The 5-year plan is to increase total stores by 22.

BCF experienced a slowing of like-for-like sales growth of -0.4% over the March quarter 2018. While NSW and Victoria saw strong growth, WA and Queensland offset these. There were 136 BCF stores in Australia as at April 2018, with the network expected to be supplemented by a further 14 stores over the 5-year outlook.

Macpac was purchased by SRG in April 2018. At that time there were 24 Macpac branded stores and nine Rays stores in Australia (which are being rebranded to Macpac).

METCASH

As at October 2017, Metcash owned 730 hardware stores across Australia under the brands of Home Timber and Hardware and related brands (365 stores), Mitre 10 (301) and True Value Hardware (64).

SPOTLIGHT RETAIL GROUP

The privately owned Spotlight Retail Group owns Spotlight and Anaconda retail operations. As at April 2018 there were 106 Spotlight stores and 50 Anaconda stores in Australia.

STEINHOFF ASIA PACIFIC

Steinhoff Asia Pacific operates a number of large format retail brands. These include Freedom (47 stores), Snooze (91), Fantastic Furniture (77), Plush (42), OMF (35) and Bay Leather Republic (13). While accounting scandals are plaguing the group their May presentation reported that the Australian business was stable with no funding required.

JB HI-FI LIMITED

JB Hi-Fi continued to perform well. March quarter 2018 comparable sales growth was 4.0%. There were 201 stores as at April 2018 up from 183 stores at April 2017.

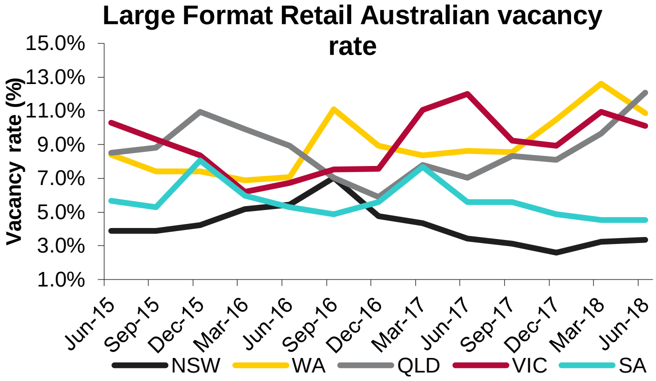
The Good Guys had a network of 102 stores as at April 2018. Like-for-like sales growth over the March quarter 2018 was -2.9%.

HARVEY NORMAN HOLDINGS LIMITED

Harvey Norman had 195 franchised stores in Australia and 87 company operated stores across seven countries. Comparable sales growth of Australian franchised stores was 4.8% in the year to December 2017, compared to the year prior.

m3property Valuation:
Bunnings Epsom, Bendigo, VIC

KEY INDICATORS

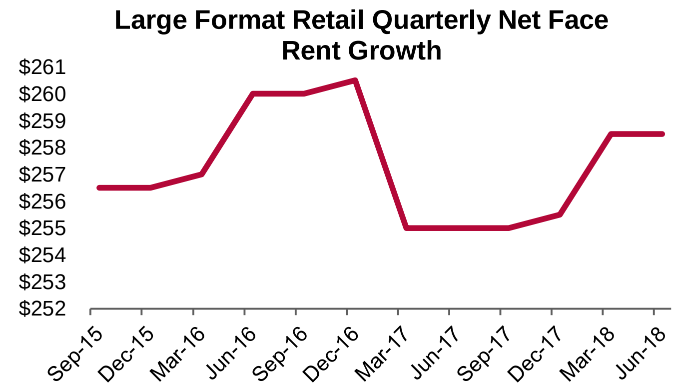


Source: Large Format Retail Survey and presentations and m3property (June 2018)

DEMAND AND VACANCY

Retail trade remains positive with growth in the key sub groups of Hardware building and garden retailing (4.9%) furniture, floor coverings, houseware and textile goods retailing (3.1%) and electrical and electronic goods retailing (1.2%). This had kept demand for large format space fairly stable over the year to March 2018.

Over the year to June 2018 vacancy reduced in large format retail space in two states. In SA vacancy reduced from 5.6% in June 2017 to 4.5% in June 2018 and Victoria reduced from 12.0% to 10.1% over the same period. There were, however, increases in vacancy in WA and Queensland, which have resulted in the overall vacancy increasing over the year to June. This was largely driven by contraction of manchester, hardware and auto retailers, which has largely occurred over the last three to six months.

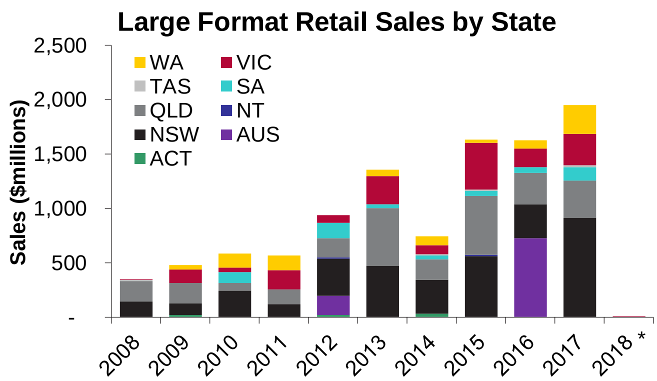


Source: m3property (June 2018)

RENTS

Annual rental growth averaged 1.4% for large format retail centres in Australia over the year to June 2018. This was largely driven by growth in SA, NSW and Victoria.

Forecasts are for moderate rental growth over the next 12-months. This is expected to be driven by a combination of continued population growth, positive household goods retail trade and the expanded retailer base now permitted within large format retail centres, offset by the slowdown in residential construction and slow wages growth. The new tenants being attracted to large format retail centres are likely to put upward pressure on rents as they often take smaller tenancies and have the ability to attract a wider customer base to the centres.



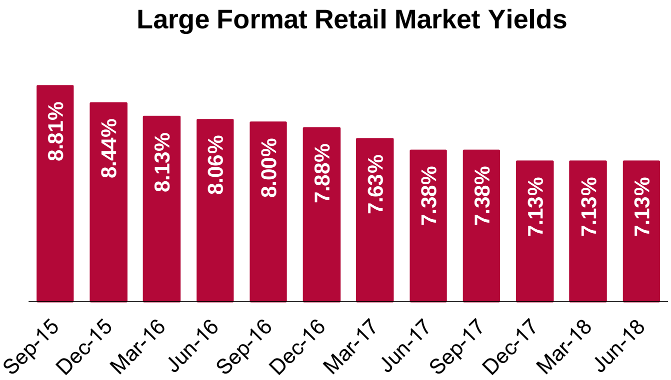
Source: m3property Research (*to end May 2018) Sales over $5 million

INVESTMENT DEMAND

Sales activity increased over the year to March 2018 compared to the year to March 2017. There were $1,750,851,000 worth of transactions over the year to March 2018, compared to $1,604,340,342 traded over the year prior. Of the sales over the past 12-months the portfolio sale of Castle Hill Home Hub and Marsden Park Home Hub by LaSalle Funds Management Limited to Aventus Property Group was the largest sale at $436,000,000.

Private investors accounted for 57.9% of total sales. Syndicates accounted for the next largest share (26.3%) of sales. Sales activity was dominated by the three most populous States over the year to March 2018, NSW (49.0%) Queensland (19.2%) and Victoria (13.1%).

KEY INDICATORS

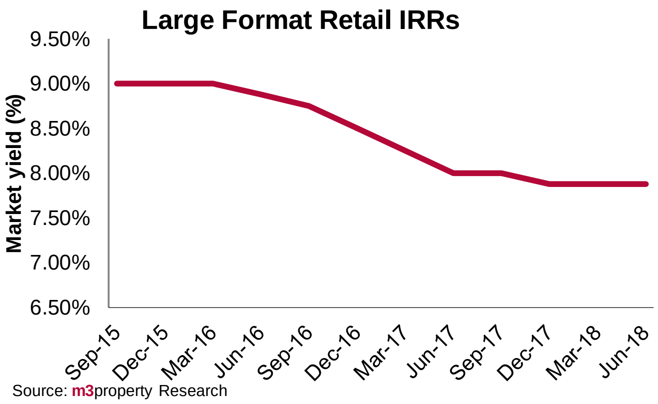


Source: m3property Research

INVESTMENT YIELDS

Large format retail centres nationally have seen yields firm by an average of around 25.0 basis points over the year to June 2018, driven by the low cost of capital and continued investor demand.

Freestanding stores occupied by ASX listed retailers such as Bunnings, Harvey Norman and Officeworks continue to be highly sought after by private investors due to strong lease covenants, long lease terms and because they are relatively easy to manage. The yields for these assets are, therefore, significantly lower than for large format retail centres.



Source: m3property Research

INTERNAL RATES OF RETURN

Demand for large format retail assets was strong over 2017. Investors reduced return expectations pushing down retail centre internal rates of return (IRRs) generally over the year. While demand for large format retail centres and stand alone stores remains solid, the 10-year bond yield has started to soften, and given current low rental growth it is expected that IRRs have peaked in the current cycle. We are therefore forecasting stable IRRs over the short-term.

Prime IRRs, as at June 2018, ranged between 7.25%-8.50% for large format retail centres nationally.

m3property Valuation:
Bunnings Collingwood, VIC.

m3property Valuation:
Smart Road, Modbury, SA.

LARGE FORMAT RETAIL IN FOCUS

SWITCHING TO LIFESTYLE CENTRES

Large format retail centres are seeing a changing tenant mix often including more traditional Shopping Centre or High Street retailers. Planning law changes across many States have facilitated this move.

One of the key drivers of this shift has been the failure of the Masters' brand and subsequent need for Bunnings to take-up larger store footprints to accommodate the increasing demand. This has presented the opportunity for proactive operators to purchase these vacated sites to create active retail and lifestyle centres.

At the same time, existing centre owners are taking the lead of Brickworks and other innovative centres to transform their traditional formats by introducing a broader range of retailers into their centres. These include supermarkets, gyms, restaurants, bars, childcare, medical, government and general services and play centres.

The increased focus on lifestyle within centres is attractive to investors and centre owners as it provides a pleasant and convenient experience for patrons, increased foot traffic and dwell time and can lower vacancy. Furthermore, new tenants crossing into large format centres usually take smaller tenancies and therefore pay higher rents per square metre than traditional large format retailers, and are capable of producing stronger returns. This has a positive impact on overall performance of these centres.

Retailers are facing challenges such as changing consumer preferences toward value and convenience, growing online competition and high rents within shopping centres. The retail planning changes have provided retailers greater flexibility, allowing them to take-up space in large format retail centres. These centres offer lower rents, greater convenience for customers and opportunities to expand into new markets.

There are several existing centres that have integrated a range of retail uses within their centres including:

- Peninsula Home, Mornington, Victoria – ALDI, Fernwood Gym;
- Epping Hub, Epping, Victoria – Snap Fitness, Kids Space, professional, government and education services, discount groceries, restaurants;
- Brickworks, Southport, Queensland – Ferry Road Markets, restaurants, bars, fashion retailers, medical services, Snap Fitness;
- Homeworld Helensvale, Queensland – play centre, restaurants, beauty, medical and other services, First Choice Fitness;
- Blacktown Mega Centre, NSW – Anytime Fitness, medical and government services, restaurants;
- Kotara Home, NSW – ALDI, Australia Post, medical services, discount retailers, Dan Murphy's;
- Homeworld Tuggeranong, ACT - ALDI, beauty and medical services, Dan Murphy's, restaurants, bars, grocery and fashion retailers;
- Joondalup Gate, WA – Coles Express, Dan Murphy's, education and medical services;
- Playford Plaza, SA – Anytime Fitness.

There are also a number of these lifestyle centres in the development pipeline. These include:

- Ouson Plaza a former Bunnings warehouse in Springvale Victoria, which is fully-leased to The Good Guys, ALDI, Crunch Fitness, Best Friends, Bottlemart, Italian Paesano Restaurant, McDonald's and Caltex (pad sites); and
- The Great Western Centre situated in Minchinbury, NSW is marketing tenancies suitable for large format, retail trade, childcare, gym and food retailers.

Home Consortium who purchased 61 former Masters' stores in August 2016 is adopting a similar approach within its portfolio developing the stores into lifestyle hubs focusing on daily retail needs (Coles and Woolworths), leisure, lifestyle (gyms), education, homewares and electrical. Eight of these stores have opened - Marsden Park, Penrith and Rutherford in NSW, Pakenham and South Morang in Victoria, and Toowomba, North Lakes and Tingalpa in Queensland with the entire national portfolio of centres expected to open by early 2019.

m3property Valuation:
Brickworks, QLD

SIGNIFICANT SALES TO DATE

Property	Date	Price	Market Yield	Building Rate (/m^2)	Major Tenants	Purchaser
Tweed Hub, 112-140 Minjungbal Dr, Tweed Heads	Dec 17	$40,0750,000	6.75%	$4,178	The Good Guys, 1st Choice Liquor	MPG Funds Management
The Zone Underwood, 183 Kingston Rd, Underwood, QLD	Dec 17	$31,250,000	7.59%	$2,824	Officeworks, Rebel, BestFriends	Private Investor
Shepparton Homemaker Centre, 290 Benalla Road, Shepparton, VIC	Dec 17	$20,000,000	6.92%*	$1,464	Fantastic Furniture	Acure Funds Management
West Gosford Hometown, 356 Manns Rd, West Gosford, NSW	Nov 17	$45,000,000	6.99%	$2,833	Super Amart, BCF, OMF, Home Essentials	Primewest Funds Management
Ipswich Homebase, 339 Brisbane St, Ipswich, QLD	Nov-17	$36,250,000	7.45%	$2,809	Fantastic Furniture, IGA Spotlight, Forty Winks	Primewest Funds Management
Nowra House and Home, 28 Central Ave, South Nowra, NSW	Nov 17	$20,300,000	6.93%	$2.507	Spotlight, Pillow Talk, BCF	Private Investor
Tuggerah Central, 9 Bryant Dr, Tuggerah, NSW	Oct 17	$10,800,000	6.55%*	$2,623	Officeworks, Nick Scali, Oz Design	Private Investor
IKEA, 6 Sunray Dr, Innaloo, WA	Aug 17	$143,500,000	7.80%	$4,782	IKEA, Kathmandu	GDI Property Group
Churchill Centre South, 252 Churchill Rd, Prospect, SA	Jul 17	$22,350,000	7.16%	$3,014	Autobarn, Beacon Lighting, Petbarn	Private Investor
Bunnings Berri, Old Sturt Hwy, Berri, SA	Jul 17	$8,631,000	6.29%	$1,316	Bunnings	Private Investor
Bunnings Colac, 130 -138 Bromfield St, Colac, VIC	Jul 17	$7,850,000	5.99%	$2,007	Bunnings	Private Investor

*Initial Yield
Please contact our Retail Valuers for further details.

Recent Sale:
West Gosford Hometown sold in November 2017

OUTLOOK
LARGE FORMAT RETAIL

New supply of large format retail centres is expected to be driven by freestanding stores again in 2018-19. Hardware retailer Bunnings, in particular, is expected to open between 15-18 new stores across various states over the next year with 17 stores already under construction. A slowing of centre supply is expected In the short-term due to slowing residential construction activity and slowing rental growth in some markets.

The Federal Government Treasury Department is forecasting economic growth of 3.0% for 2018-19 and the three financial years following. This is well above other advanced economies and bodes well for retail over the next few years.

While Queensland and WA continue to see challenging conditions, due to excess capacity, the other States continued to see falling vacancy rates and positive low rental growth in large format retail space. Changing tenancy mixes, consumer preferences towards convenience and value, continued population growth, low unemployment rates and expected wages growth is likely to result in most states witnessing positive conditions over the short- to medium-term.

Yield compression occurred nationally over the year to June 2018, this is expected to have reached the end of the tightening cycle and is expected to stabilise in the short-term. IRRs are forecast to have already bottomed out and are also likely to be stable in the short-term due to rising 10-year bond rates.

It is expected that investor demand will slow over 2018 compared to 2017, there is continued interest in the sector, which is coming largely from private investors and syndicates.

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