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Property Times

Auckland Retail
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Market Overview

Retailers are continuing to report significantly weaker turnover as discretionary spending has reduced due to the higher cost of essential items such as energy and food, and as consumers seek to reduce debt in the face of increased labour market uncertainty. The ability of a growing number of retailers to continue to pay higher rents is coming into question, with some local and national retailers closing their stores. Retail vacancy, particularly in secondary locations, has increased.

Rents in most prime retail locations have remained relatively static over the past year. The rate of retail sales growth, both in Auckland and nationally, has slowed significantly over the past year. This negative trend has been largely driven by significant food and energy price inflation and higher interest rates (more recently reversed) placing pressure on household budgets, along with a sharp decline in new residential building, falling house values and a weaker labour market. Over the last two quarters however, consumer confidence across the Auckland region has picked up and is once again positive, albeit just, following a fall to its lowest level in over ten years in the June 2008 quarter.

From an investor perspective, the key issues that will have an impact on their investment decisions are the uncertainty over the timing of the economic recovery, coupled with the strength of specific tenant covenants, and the investors ability to access funding.

Retail Property Market Drivers

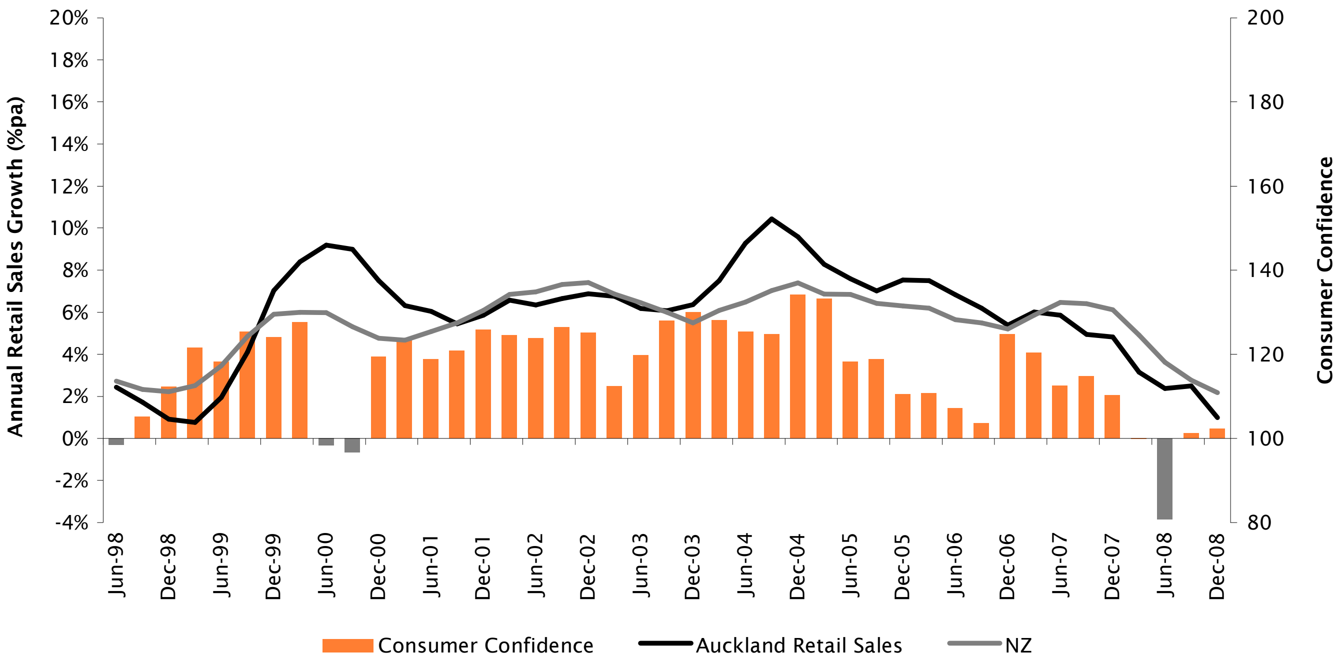
The performance of a region's retail property market is influenced by trends in its economic and demographic drivers in conjunction with supply trends. Key demand factors likely to influence the performance of the retail sector include:

- Consumer confidence;
- Disposable income growth;
- Employment and labour force participation rates;
- Interest rates;
- Access to credit;
- Economic growth (both national and regional);
- Population growth; and
- Personal / household wealth.

The combination of these factors has resulted in continued nominal growth in retail sales across the Auckland region; however the rate of growth has slowed significantly over the past twelve months.

Figure 1 presents the trend in Auckland consumer confidence together with the trend in Auckland and New Zealand retail sales since 1998.

Figure 1: Auckland Consumer Confidence and Quarterly Retail Sales



Source: Westpac and Statistics New Zealand

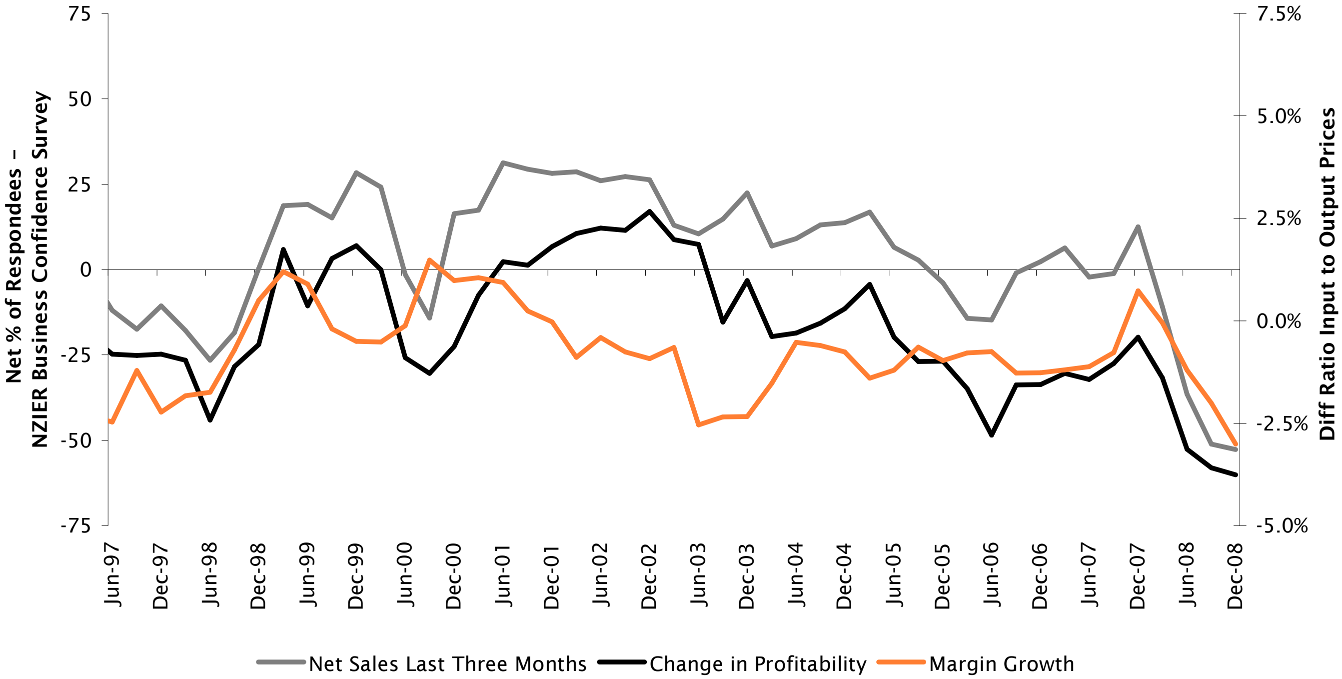
The rate of retail sales growth in Auckland fell from 4.8% per annum in the year to December 2007 to 1.0% in the year to December 2008; down from 2.5% in the year to September 2008. This is the lowest annual rate of growth observed in Auckland retail sales since the year ended March 1999. The slowdown in retail sales growth is due to a range of factors including; previous interest rate increases, higher food prices, higher energy costs, weaker consumer confidence, weaker net migration gains, weak or negative household wealth growth and a weak labour market.

Nationally, the rate of retail sales fell from 6.1% per annum in the year to December 2007 to 2.2% in the year to December 2008. Annual retail sales growth has been stronger nationally than in Auckland since June 2007, the first time this has occurred for seven consecutive quarters since mid 2002. This reflects changing economic growth relativities between Auckland and rest of the country.

The December 2008 quarter Auckland consumer confidence measure (102.3) continues to reverse its recent negative trend, following a drop to its lowest level in over ten years (80.8) in the June 2008 quarter. This meant, that for the second consecutive quarter, the number of optimists outweighed the number of pessimists, albeit only slightly.

Figure 2 illustrates the trend in net sales, profitability and margin growth within the retail sector since mid 1997.

Figure 2: Retail Profitability



Source: NZIER

Retailer's net sales, profitability and margin growth has turned sharply negative since the beginning of 2008. While net sales growth has been variable over the last two years, the most recent survey stands out as the most negative in over ten years. Similarly, profitability growth, which has been negative since mid 2003, in the latest survey exceeded ten year lows. Retailer's margin growth, measured as the difference between the growth in input and output costs, which was briefly positive over the second half of 2007, has turned sharply negative over the last four quarters. All this suggests that the margin and profitability pressures that retailers have been under over the last 3 to 4 years have, over the last year, significantly increased. This would suggest that their ability to pay higher rents, or even existing rents in some cases, is likely to be constrained in the short to medium term.

Table 1 presents the New Zealand wide trend in annual sales growth by store type.

Table 1: National Retail Sales Growth by Store Type

Store Type	Annual Sales Growth ($M Dec 2008 Year)	Annual Retail Sales Growth (Year End)			
		Dec 2005	Dec 2006	Dec 2007	Dec 2008
Food Retailing	1,693.20	9.6%	5.7%	-4.5%	-1.2%
Supermarkets	14,398.00	5.1%	6.3%	7.4%	6.6%
Footwear	451.40	8.7%	12.7%	10.8%	4.9%
Clothing & Softgoods	2,579.50	11.1%	3.1%	6.3%	-0.5%
Furniture & Floor Coverings	1,426.40	8.1%	3.8%	6.9%	-12.1%
Appliance Retailing	2,481.10	10.4%	3.5%	5.1%	-2.1%
Hardware	1,486.80	15.7%	5.6%	14.0%	-3.5%
Chemist	1,838.30	4.4%	6.3%	4.3%	2.9%
Department	3,836.80	3.0%	3.6%	5.2%	2.0%
Recreational Goods	2,284.20	1.2%	2.9%	7.1%	-2.9%
Accommodation, Hotels & Liquor	3,851.40	6.9%	3.4%	6.2%	2.7%
Cafes, Restaurants & Takeaways	5,109.80	10.9%	8.2%	6.5%	1.8%
Other	1,778.70	2.4%	9.0%	4.4%	3.8%
Personal & Household Services	227.00	3.3%	11.5%	4.2%	-8.1%
Sub Total (Ex Motor Vehicles)	***47,910.20***	***6.3%***	***5.2%***	***6.1%***	***2.2%***
Motor Vehicle Retailing	14,623.30	6.2%	1.3%	6.9%	-0.4%
Motor Vehicle Services	3,443.00	7.6%	3.7%	3.9%	-1.0%
Total	***65,976.40***	***6.4%***	***4.2%***	***6.2%***	***1.4%***

Source: Statistics New Zealand

In the year to December 2008 over half of all store type categories experienced negative growth. With the exception of 'Food Retailing', where sales growth increased by 3.3 percentage points, all categories experienced a decline in sales growth over the twelve months from December 2007 to December 2008, with 'Furniture and Floor Coverings', 'Hardware' and 'Personal and Household Services' experiencing the most significant decline, down 19.0, 17.5 and 12.4 percentage points respectively.

Development Activity

Strong growth in retail sales over recent years is reflected in the large quantity of new retail space recently completed and still being developed. Development activity continues to be dominated by institutional investors looking to secure market share within key suburban catchments. In the CBD few opportunities exist to develop further retail space. As a result of this constraint owners are adopting a range of strategies to intensify the use of existing retail space and incorporate retail activity into traditionally non-retail properties. More recently we perceive that retail development activity has generally slowed significantly.

Retail developments recently completed, underway and proposed for the future include:

- Westfield has completed stages one and two of its new 70,000 square metre shopping mall in Albany, securing a number of key anchor tenants including Farmers, K-Mart and New World, as well as a 10 cinema SkyCity multiplex. The development includes 142 shops and cost approximately $210 million. Construction commenced in late 2006 and the retail component opened in November 2007 with the cinema complex completed and opened mid 2008. Albany is the largest Westfield shopping mall in New Zealand. Westfield has development plans for third stage at Albany, which is expected to commence in mid 2009 and is expected to add at least 50 further retail outlets;
- Symphony Projects Management has almost completed 'E2', which forms part of its 'Gateway Albany City' development. E2 comprises a $61.5 million home and DIY shopping precinct on Oteha Valley Road which upon completion will house 10 large format retail stores. Construction began in late 2007 on a 12,500 square metre Mitre 10 Mega store, the key anchor tenant, which opened just prior to Christmas 2008. Other key tenants include Retravision, Freedom Furniture and Beds R Us. Symphony's E1 and E3 precincts will also comprise up to 11,000 square metres of retail space – these are yet to commence construction;
- In 2008 AMP Capital Investors completed refurbishment of the Imperial Building at 48 – 50 Queen Street. The revamped building includes ground floor retail, 3 floors of character office space and 6 luxury apartments on the top floor. High end tenants Louis Vuitton and Gucci have leased the retail space;
- The new Deloitte Centre, a Multiplex development currently under construction at 80 Queen Street will, upon completion in October 2009, provide over 1,500 square metres of ground floor, high end retail space;
- Marlin Group's Soho Square development, a large mixed use development consisting of office, retail and residential space located in Ponsonby, is expected to include approximately 12,500 square metres of retail space, this development is currently on hold;
- Redwood Group has gained resource consent to develop a $75 million, 14 store, bulk retail centre opposite Sylvia Park on the Mt Wellington Highway. The retail centre will comprise 13,777 square metres of gross floor area;
- AMP Capital Investors has obtained resource consent to expand Botany Town Centre to provide an additional 5,500 square metres of retail space (approximately 30 new retailers), called the 'Orchard Building'. Resource consent for a further 400 car parks is pending. Originally expected to be completed by mid 2009, this development has been delayed for at least 18 months;
- Pelago Limited has applied for resource consent to redevelop the old Cook Street Council Depot into a 147,876 square metre mixed use development, including approximately 3,793 square metres of retail space;
- Westfield are awaiting resource consent to redevelop and expand its 277 Broadway shopping mall in Newmarket, as well as linking it to a new mall development proposed for the adjacent Farmer's Extreme site on Mortimer Pass; and
- AMP Capital Investors have recently entered into an agreement to purchase the Lion Brewery site on Khyber Pass Road in Newmarket. It is expected that once the site has been re-zoned the proposal will comprise a significant mixed use development including a substantial portion of retail space.

Leasing Activity

Whilst most prime retail areas are continuing to experience strong demand and low vacancy, conversely the secondary retail market has been hit hard by the recession, with many stores forced to close. Table 2 presents the typical rent ranges achieved in the key Auckland prime retail precincts.

Table 2: Retail Rents

	Typical Rental Range ($Net psm)	
Location	December 2007	December 2008
Prime Queen Street	$1,750 - $2,800	$1,750 - $2,750
High Street	$1,000 - $1,400	$900 - $1,300
Prime Newmarket	$1,200 - $2,300	$1,200 - $2,250

Source: Darroch Research

Over the past twelve months prime retail rents in both Queen Street and Newmarket have remained relatively flat, following a period of sustained strong rental growth in recent years. Rental levels in the High Street retail area, however, have been adversely affected by the downturn in the economy, softening at both the bottom and top ends with a notable increase in vacancy.

Recent retail leases and reviews are presented in Table 3.

Table 3: Retail Leases and Reviews in Prime Locations

Address	Tenant	Date	Total Area (sqm)	Rental Range ($Net psm)
Queen Street				
185-189 Queen Street	STA Travel	Jan-09	32	$2,650 - $2,750
22-32 Queen Street	Travelex	Aug-08	60	$2,400 - $2,500
62 Queen Street	Real Aotearoa	Jul-08	60	$2,300 - $2,400
40A Queen Street	Graham Thompson Jewellery	Jun-08	38	$2,400 - $2,500
High Street				
53 High Street	Veronika Maine	Aug-08	83	$1,500 - $1,600
Newmarket				
160 Broadway	Vodafone	Oct-08	84	$1,400 - $1,500
160 Broadway	Flight Centre	Sep-08	47	$1,200 - $1,300
238 Broadway	Lush	Aug-08	62	$1500 - $1,600
248 Broadway	Confidential	Jun-08	58	$1,500 - $1,600

Source: Darroch Research

Investment Market

There has been a significant reduction in the level of investment demand for retail property during late 2008 and early 2009. Recent retail investment sales include:

- 145 Karangahape Road, Auckland, sold in March 2009 for $2,044,000 at a yield of 8.4%. This equates to a sale price of $2,024 psm;
- 95 Queen Street, Auckland, sold in January 2009 for $5,100,000 at a yield of 6.6%. This equates to a sale price of $6,667 psm;
- 38-44 Broadway, Newmarket, sold in December 2008 for $3,725,000 at a yield of 8.2%. This equates to a sale price of $3,721 psm;
- 68 Victoria Street West, Auckland, sold in December 2008 for $3,175,000 at a yield of 7.9%. This equates to a sale price of $17,938 psm;
- 23 Victoria Street East, Auckland, sold in December 2008 for $7,250,000 at a yield of 6.7%. This equates to a sale price of $4,506 psm;
- 9 High Street, Auckland, sold in December 2008 for $4,625,000 at a yield of 7.2%. This equates to a sale price of $5,884 psm; and
- In August 2008, Centro Properties sold the Meadowlands Shopping Centre to an Australian investor for between $14,000,000 and $15,000,000, at a yield of 9.1%. The centre is anchored by Woolworths, has 21 specialty shops, and a single office tenancy.

Investors generally are taking a much more cautious approach, with the ability to access funding constraining those wanting to buy. Yields for secondary properties have increased and we are likely to see yield margins between prime and secondary widen further.

There is limited quality data available on the past return performance of the different sectors of the New Zealand property market. Table 4 presents the total return delivered by retail, industrial and CBD office property over the last year, two years, five years and ten years.

Table 4: Retail, Office and Industrial Annual Compound Returns

To September 2008	NZ Retail	NZ Industrial	Auckland Office (CBD)
1 Year	8.7%	8.2%	12.4%
2 Years	16.0%	11.1%	18.2%
5 Years	16.3%	14.5%	17.4%
10 Years	13.9%	12.2%	10.4%

Source: Darroch Research and New Zealand Property Council

N.B. Returns series based on the New Zealand Property Council's index up to March 2006, and since then Darroch's return series.

With the exception of the past 12 months, retail returns had achieved 16% over the last five years; however, over the same period the Auckland CBD Office market has consistently, albeit slightly, out performed the retail sector in terms of annual returns.

Market Outlook

The outlook for the retail market is for the total volume of sales to continue to grow but at a much slower rate than in the past. The positive factors which have underpinned growth over the last five or so years have weakened substantially with households, particularly those with high debt levels, reducing discretionary spending. Household discretionary spending remains under extreme pressure and this is likely to result in an ongoing weakness in retail sales growth. The impact of this is already evident with an increase in vacancies in many secondary retail locations.

Looking forward, over the short to medium term the recent tax cuts and falls in interest rates and fuel costs will provide some support for the retail sector. However, offsetting this will be a forecast much softer labour market and ongoing weakness in the housing market.

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