

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 pay higher rents is likely to continue to be constrained, with some local and national retailers closing their stores. Retail vacancy, particularly in secondary locations, has increased.

Rents in prime retail locations have remained stable or decreased over the past year, especially in the prime Newmarket retail area. 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 rising unemployment and employment concerns, general price inflation, weak or negative household wealth growth and a weak residential building sector. However, consumer confidence across the Auckland region is once again positive.

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

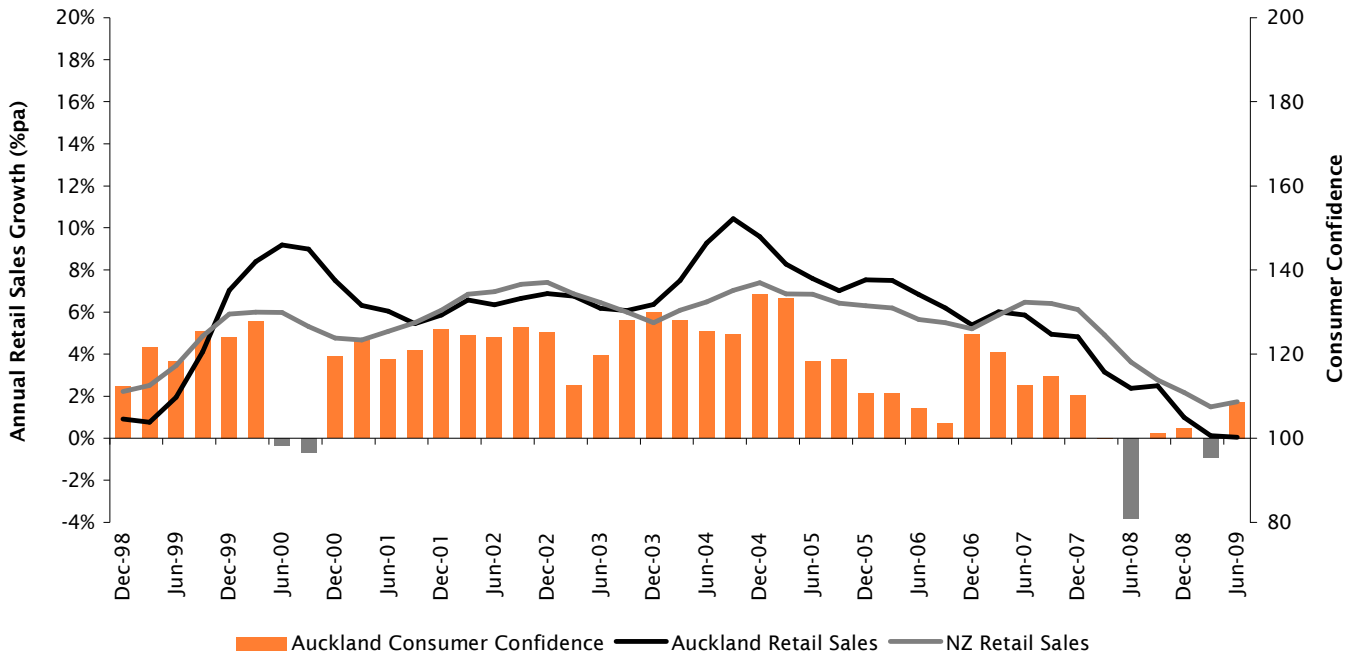
The performance of a region's retail property market is influenced by trends in its economic and demographic drivers in conjunction with supply trends. Key demand factors likely to influence the performance of the retail sector include:

- 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 strong nominal growth in retail sales across the Auckland region over the last decade; 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 2.4% in the year to June 2008, to 0.1% in the year to June 2009, an annual rate unchanged from March 2009. A growth rate of 0.1% is the lowest annual rate of retail sales growth recorded in Auckland in over 10 years. The slowdown in retail sales growth is due to a range of factors including; rising unemployment and employment concerns, general price inflation, weak or negative household wealth growth and a weak residential building sector.

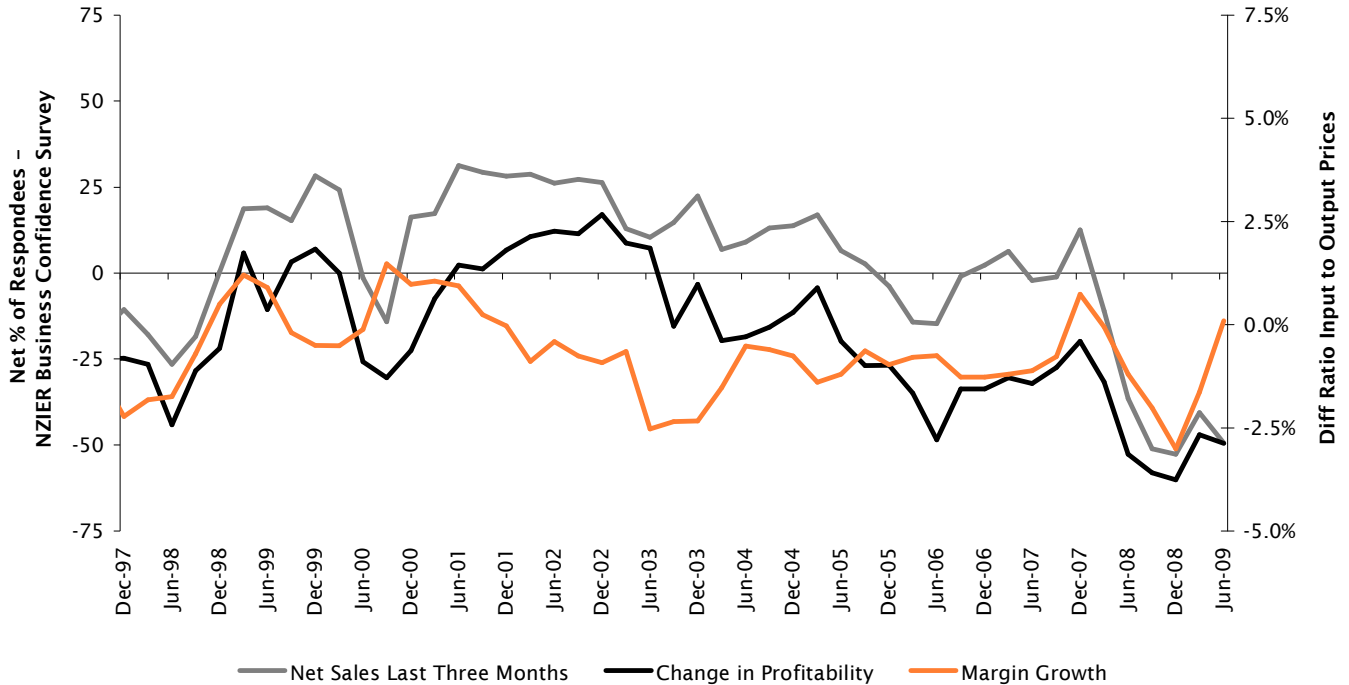
Nationally, the rate of retail sales growth fell from 3.6% in the year to June 2008, to 1.7% in the year to June 2009. This is slightly stronger than the retail sales growth in the year to March 2009, 1.5%. New Zealand wide retail sales growth has been consistently stronger than Auckland retail sales growth since June 2007.

The June 2009 quarter Auckland consumer confidence measure rose to a positive measure of 108.6, which means the number of optimists outweighed the number of pessimists. Over the last eighteen months consumer confidence in the region has been very volatile swinging from 110.3 in December 2007 to 80.8 in June 2008, its lowest level in 10 years.

Retailers are reporting significantly lower turnover as discretionary spending from consumers has reduced. As a result the ability of retailers to continue to pay higher rents is a key issue, with some local and national retailers selectively closing stores.

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 and profitability have weakened over the last quarter after slight rebounds in the March 2009 quarter. Retailer’s margin growth, measured as the difference between the growth in input and output costs, delivered a positive result in the June 2009 quarter for the first time since December 2007, indicating a significant focus by retailers on costs over the period. Figure 2, however, shows that for a number of years retailer’s costs have been rising faster than their prices, which is consistent with them experiencing a decline in profitability. This would suggest that their ability to pay higher rents is likely to continue to be constrained in the short 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	Annual Retail Sales Growth (Year End)			
	Growth (\$M Jun 2009 Year)	Jun-06	Jun-07	Jun-08	Jun-09
Food Retailing	1,745.00	6.5%	3.3%	-8.4%	6.0%
Supermarkets	14,807.80	6.2%	7.4%	7.7%	5.3%
Footwear	462.30	13.6%	12.5%	7.2%	4.2%
Clothing & Softgoods	2,557.50	9.3%	4.2%	1.8%	-0.9%
Furniture & Floor Coverings	1,318.80	4.8%	6.1%	-0.5%	-15.9%
Appliance Retailing	2,501.20	1.9%	9.5%	-4.1%	2.6%
Hardware	1,436.20	12.0%	9.9%	6.8%	-7.1%
Chemist	1,872.30	4.2%	7.6%	1.1%	4.5%
Department	3,794.80	3.3%	4.3%	3.2%	0.2%
Recreational Goods	2,305.50	0.6%	7.5%	0.9%	-1.0%
Accommodation, Hotels & Liquor	3,808.60	48.4%	5.4%	5.0%	-0.3%
Cafes, Restaurants & Takeaways	5,144.20	45.0%	6.4%	4.5%	0.9%
Other	1,774.70	6.8%	6.9%	3.7%	1.6%
Personal & Household Services	230.80	-1.5%	14.7%	-4.1%	-3.3%
Sub Total (Ex Motor Vehicles)	48,277.90	5.6%	6.5%	3.6%	1.7%
Motor Vehicle Retailing	13,315.70	4.1%	2.2%	7.4%	-11.7%
Motor Vehicle Services	3,414.90	8.2%	1.7%	3.7%	-2.7%
Total	65,008.50	5.4%	5.2%	4.5%	-1.6%

Source: Statistics New Zealand

In the year to June 2009 many store type categories experienced negative growth with 'Furniture and Floor Coverings', 'Motor Vehicle Retailing' and 'Hardware' experiencing the most significant decline, down 15.9%, 11.7% and 7.1% respectively. Sectors to show the strongest growth included food retailing (6.0%), supermarkets (5.3%), chemists (4.5%) and footwear (4.2%).

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 slowed significantly.

Retail developments recently completed, underway or 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 with the retail component opening in November 2007, and the cinema complex completed and opened mid 2008. Albany is the largest Westfield shopping mall in New Zealand. Westfield has development plans for a third stage at Albany which is expected to add at least 50 further retail outlets, however, this proposal is currently on hold;
- 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, 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), to be 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 have proposed 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. Like most new retail developments, however, this proposal has been put on hold; 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 low vacancy, tenant demand is softening. 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

Location	Typical Rental Range (\$Net psm)	
	June 2008	June 2009
Prime Queen Street	\$1,750 - \$2,750	\$1,750 - \$2,750
High Street	\$1,000 - \$1,400	\$900 - \$1,300
Prime Newmarket	\$1,750 - \$2,250	\$1,100 - \$2,100

Source: Darroch Research

Over the past twelve months prime retail rents in Queen Street have remained relatively stable, following a period of sustained strong rental growth in recent years. Rental levels in both the High Street and Newmarket retail areas, 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
110 Queen Street	Overland	Jan-09	67	\$1,950 - \$2,050
22-32 Queen Street	Travelex	Aug-08	60	\$2,400 - \$2,500
62 Queen Street	Real Aotearoa	Jul-08	60	\$2,300 - \$2,400
High Street				
53 High Street	Veronika Maine	Aug-08	83	\$1,500 - \$1,600
Newmarket				
38-44 Broadway	Natuzzi	Jan-09	434	\$350 - \$450
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

Source: Darroch Research

Incentives are becoming a prominent feature in new retail leases and there has been very limited activity over the past six months. In some circumstances landlords are waiving rent reviews within existing leases and in some more extreme cases rents are being reduced in order to retain tenants.

Investment Market

There has been a significant reduction in the level of investment demand for retail property over the last twelve months. Over the last nine months there have been few major retail investment sales. Those that have include:

- The Rialto Centre and adjoining Carlton DKF Tower in Newmarket were purchased by Ladstone Holdings Limited in August 2009 for \$49,000,000. Ladstone Holdings proposes to market the space following a strata and unit titling;
- Eden Quarter Retail Complex, 284 Dominion Road, Mt Eden sold in August 2009 for \$2,500,000 at a yield of 4.8%. The building is leased to ANZ National;
- NZ Post sold seven of their properties in May 2009, of these five were located in Auckland. The highest sale was the store in Remuera which sold for \$13,100,000. The other four Auckland properties ranged in price from \$4,720,000 and were located in Browns Bay, New Lynn, St Heliers and Parnell;
- 76-82 Broadway, Newmarket, sold in April 2009 for \$14,100,000 at a yield of 8.3%. The building is tenanted with Noel Leeming as the anchor tenant and Burger King and a café as other tenancies;
- 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; and
- 240 Broadway, Newmarket was sold with vacant possession in March 2009 for \$1,600,000.

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.

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 March 2009	NZ Retail	Industrial	Auckland Office (CBD)
1 Year	-1.3%	2.6%	-2.0%
2 Years	10.6%	8.0%	9.3%
5 Years	14.1%	13.2%	13.8%
10 Years	13.1%	11.8%	8.9%

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 10% over the last five years. Over the same period the Auckland CBD Office market has consistently, albeit slightly, under 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 and our expectation is for retail rents to continue to soften.

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. Our expectation is for these trends to continue in the short term. However, offsetting this will be a forecast much softer labour market and ongoing weakness in the housing market.

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