Market Overview

Over the last five years the strong growth in retail sales, combined with demand from global retail brands, has boosted demand for retail space along Wellington's 'Golden Mile.' This has resulted in limited, if any, retail vacancies, which has seen strong rental growth and an overflow from the traditional retail sites along Lambton Quay, Willis Street and Manners Streets onto adjacent CBD locations. Over the last twelve months, however, a weakening economy, higher interest rates, general price inflation and increased uncertainty across the labour market tempered consumers' appetite for retail spending.

CBD retail rents in most areas have declined over the last year at both the top and bottom ends and some secondary locations are beginning to see vacancy appear. Notwithstanding, retail sales growth in the Wellington region has remained surprisingly buoyant over the last year, whilst consumer confidence in the region has seen two consecutive positive quarter results, reversing the negative trend seen in the first half of 2008.

A policy change which will have longer term implications for retail development in Wellington City was the passing in 2008 of District Plan Change 66. In the face of a number of mooted and proposed retail developments outside of the CBD, council moved to require any retail development in the central area and suburban centres, that exceed a defined size threshold, to seek consent as a discretionary activity (restricted). Council's discretion will be limited to the impact of the development on the sustainability of the cities existing retail centres, the sustainability of the transport network, and the location of retail activities within Wellington City.

Retail Property Market Drivers

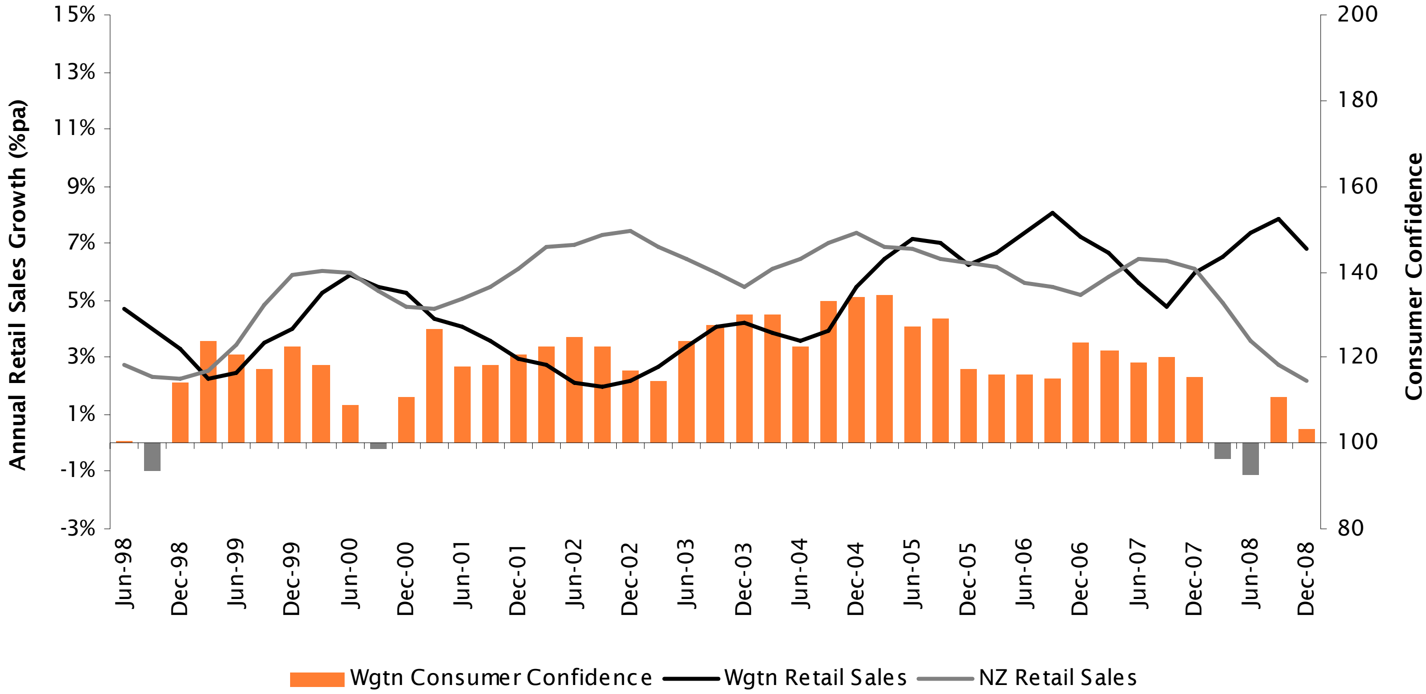
The performance of a region's retail property market is influenced by trends in its economic and demographic drivers, in conjunction with supply trends. Key demand factors likely to influence the performance of the retail sector include:

- 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 growth in retail sales across the Wellington region.

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

Figure 1: Wellington Consumer Confidence and Retail Sales Growth



Source: Westpac and Statistics New Zealand

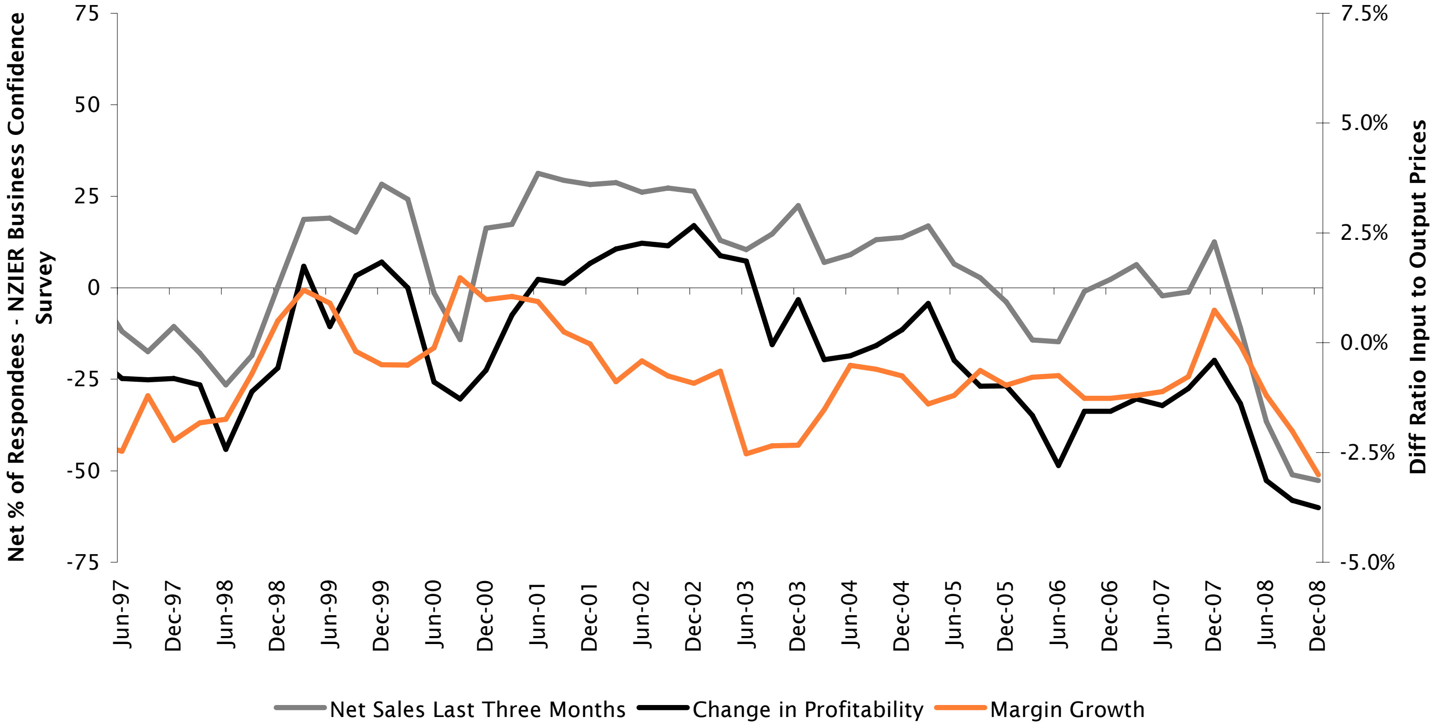
The rate of retail sales growth in Wellington lagged New Zealand wide sales growth over the five years to 2005, particularly compared to those areas experiencing strong migration led population growth. This pattern was reversed in the period to March 2007, with the rate of Wellington sales growth ahead of the New Zealand wide rate. Over the three quarters to December 2007, Wellington's retail sales growth once again fell below the national average, albeit slightly. Over the last year, however, retail sales growth in the Wellington region has remained relatively robust compared to sales growth as a whole across the country which has weakened significantly.

The growth in sales in the Wellington region over the December 2008 year was 6.8%, down on the 7.9% growth recorded in the September 2008 year, however, an increase of 0.9 percentage points over the sales growth recorded for the previous corresponding period. 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.

The December 2008 quarter Wellington consumer confidence measure (103.2) continues to reverse its recent negative trend, following a drop to its lowest level in over ten years (92.8) in the June 2008 quarter. Which meant, for the second consecutive quarter, the number of optimists outweighed the number of pessimists, albeit only slightly.

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

Figure 2: Retail Sales, Profitability and Margin Growth Trends



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

There are a small number of significant retail developments and refurbishments that have either recently been completed, are under construction or proposed for the Wellington region. These include:

- Willis Bond & Co's 'Chews Lane Precinct' in the CBD, with approximately 19 units of shopping, cafes and restaurants, was completed mid 2008. AMP NZ Office Trust has purchased the completed development, which also includes an office tower and associated car-parking;
- Construction has been completed on a 3,000 square metre retail centre at 50 Tacy Street, Rongotai. The development will has five individual retail units ranging from 200 square metres to 1,000 square metres. The largest of the retail units has been leased to Big Save Furniture;
- A 0.8 hectare site on the corner of Tasman, Rugby and Belfast Streets has been cleared in preparation for development. Foodstuffs are proposing either a 6,000 square metre Pak 'n' Save supermarket or a smaller New World supermarket. Both proposals contain a residential apartment component and car parking;
- DNZ, owners of the Johnsonville shopping centre propose a comprehensive redevelopment and expansion of the existing centre. This project is currently in planning with resource consent still to be secured; and
- A $17 million redevelopment of Coastlands Mall, located in Paraparaumu, was recently announced. The two stage redevelopment will include additional floor space as well as a complete new look inside and out. The project is expected to be completed by mid 2010.

Leasing Activity

Table 2 demonstrates the typical rental ranges for retail in the CBD.

Table 2: Retail Rents

	Typical Rental Range ($Net psm)	
Location	December 2007	December 2008
Prime Lambton Quay	$2,300 - $2,500	$2,100 - $2,400
Featherston Street	$850 - $1,250	$800 - $1,100
Willis Street	$900 - $1,600	$750 - $1,500
Courtenay Place	$680 - $1,000	$700 - $975

Source: Darroch Research

CBD retail rentals have declined in most areas over the last year at both the top and bottom ends, and while demand remains strong for premium locations along Lambton Quay some secondary areas are starting to see vacant retail units. Over the course of the last decade there has been an overflow of demand from Lambton Quay to Featherston Street and more recently to Willis Street. At the same time Courtenay Place and Cuba Street have continued to evolve with both now offering an eclectic mix of bars, cafes, restaurants, as well as conventional retail.

It is our expectation that rents will continue to consolidate at current levels in the short term.

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)
The Terrace				
97 The Terrace	Turkan Design	Sep-08	64	$900 - $1,000
Cuba Street				
2 Manners Street	NZ Post	Sep-08	307	$500 – $600
109 Cuba Street	Tiger Eye Beads Ltd	Jun-08	96	$650 - $750
1 Manners Street	E21	May-08	24	$1,000 - $1,100
Lambton Quay				
342-352 Lambton Quay	Principals	Feb-09	85	$2,400 - $2,500
256 Lambton Quay	YD	Feb-09	111	$1,850 - $1,950
184 Lambton Quay	Diva / Mrs Higgins	Dec-08	57.9	$2,700 - $2,800
215 Lambton Quay	Esprit	Nov-08	242	$1,900 - $2,000
195-201 Lambton Quay	The Bay (Apple)	Oct-08	96	$1,800 - $1,900
358 Lambton Quay	Vodafone	Sep-08	79	$2,500 - $2,600
192 Lambton Quay	Strand Bags	Sep-08	92	$1,800 - $1,900
195-201 Lambton Quay	Swarovski	Sep-08	88	$2,300 - $2,400
Willis Street				
70 Willis Street	Parallel Direct Ltd	Jul-08	100	$700 - $800

Source: Darroch Research

Investment Market

Over the last six months there have been few, if any, major retail investment sales. Smaller sales include:

- Cnr Cuba and Wakefield Streets, Wellington, sold in December 2008 for $1,345,000 at a yield of 6.6%. This equates to a sale price of $7,390 psm. The unit is leased to Felix Café;
- 176-186 Cuba Street, Wellington, sold in December 2008 for $904,000 at a yield of 8.6%. This equates to a sale price of $3,398 psm. The unit is leased to Flying Burrito Brothers; and
- 75 Featherston Street, Wellington, sold in October 2008 for $1,050,000 at a yield of 8.7%. This equates to a sale price of $6,863 psm. The unit is leased to Esquires Coffee.

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, Shopping Centre and Office Annual Compound Returns

To September 2008	NZ Retail	NZ Industrial	Wellington Office (CBD)
1 Year	8.7%	8.2%	11.4%
2 Years	16.0%	11.1%	18.7%
5 Years	16.3%	14.5%	19.6%
10 Years	13.9%	12.2%	13.4%

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 Wellington 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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