
Market Overview

Over the last decade the strong growth in retail sales, combined with demand from global retail brands, had boosted demand for retail space along Wellington's 'Golden Mile.' This had resulted in limited, if any, retail vacancies, strong rental growth and an overflow from the traditional retail sites along Lambton Quay, Willis Street and Manners Streets onto adjacent CBD streets. However, the change in economic conditions over the last eighteen months, the softening of the labour market and, until recently, low levels of consumer confidence, has had a dramatic impact on the retail sector. Demand for space has fallen and vacancies increased, particularly in secondary locations, as retailers' turnover and profitability has declined.

Rents in prime retail locations have been flat over the past year and have softened in no-prime locations. The rate of retail sales growth has improved nationally over the last twelve months; however, a significant decline has been experienced in the Wellington region with negative retail sales growth recorded in the year to December 2009. Consumer confidence, however, across the Wellington region is once again positive.

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.

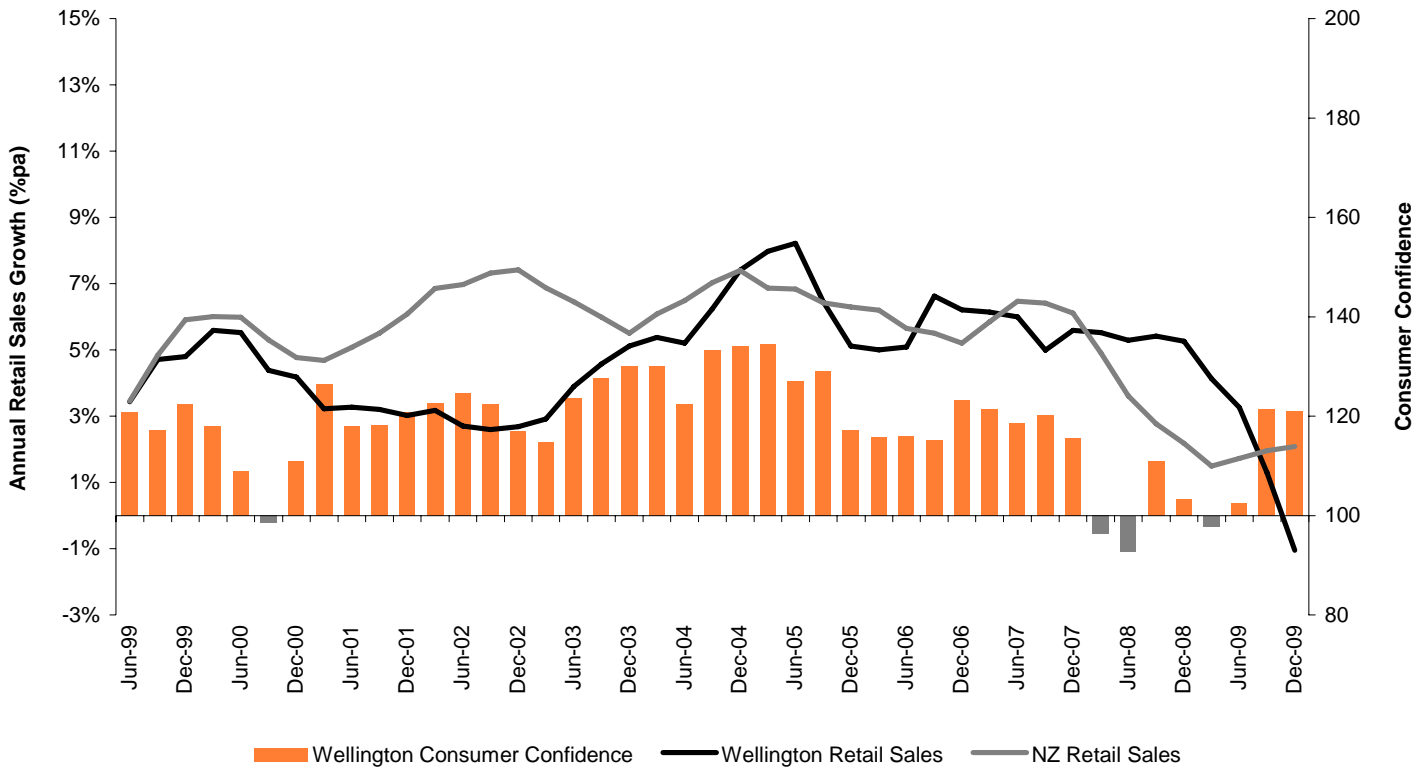
Retail Property Market Drivers

The performance of a region's retail property market is influenced by trends in its economic and demographic drivers, in conjunction with supply trends. The combination of these factors had resulted in strong nominal growth in retail sales across the Wellington region over the last decade; however, the rate of growth has dropped significantly over the past twelve months.

It is important to note that whilst improved consumer confidence and policy stimulus to lower interest rates has seen a recent increase in household spending, market expectations about interest rate increases over the next two years remain strong and the rate of private sector credit growth is very low, indicating households are less willing to take on debt.

Figure 1 presents the trend in Wellington consumer confidence together with the trend in Wellington and New Zealand retail sales since mid 1999.

Figure 1: Wellington Consumer Confidence and Retail Sales Growth (excluding Motor Vehicles)



Source: Westpac and Statistics New Zealand

The growth in sales in the Wellington region over the December 2009 year (-1.0%) was negative for the first time in over ten years, well down on the 5.3% growth recorded in the December 2008 year, and the fifth consecutive quarterly decline in annual retail sales growth.

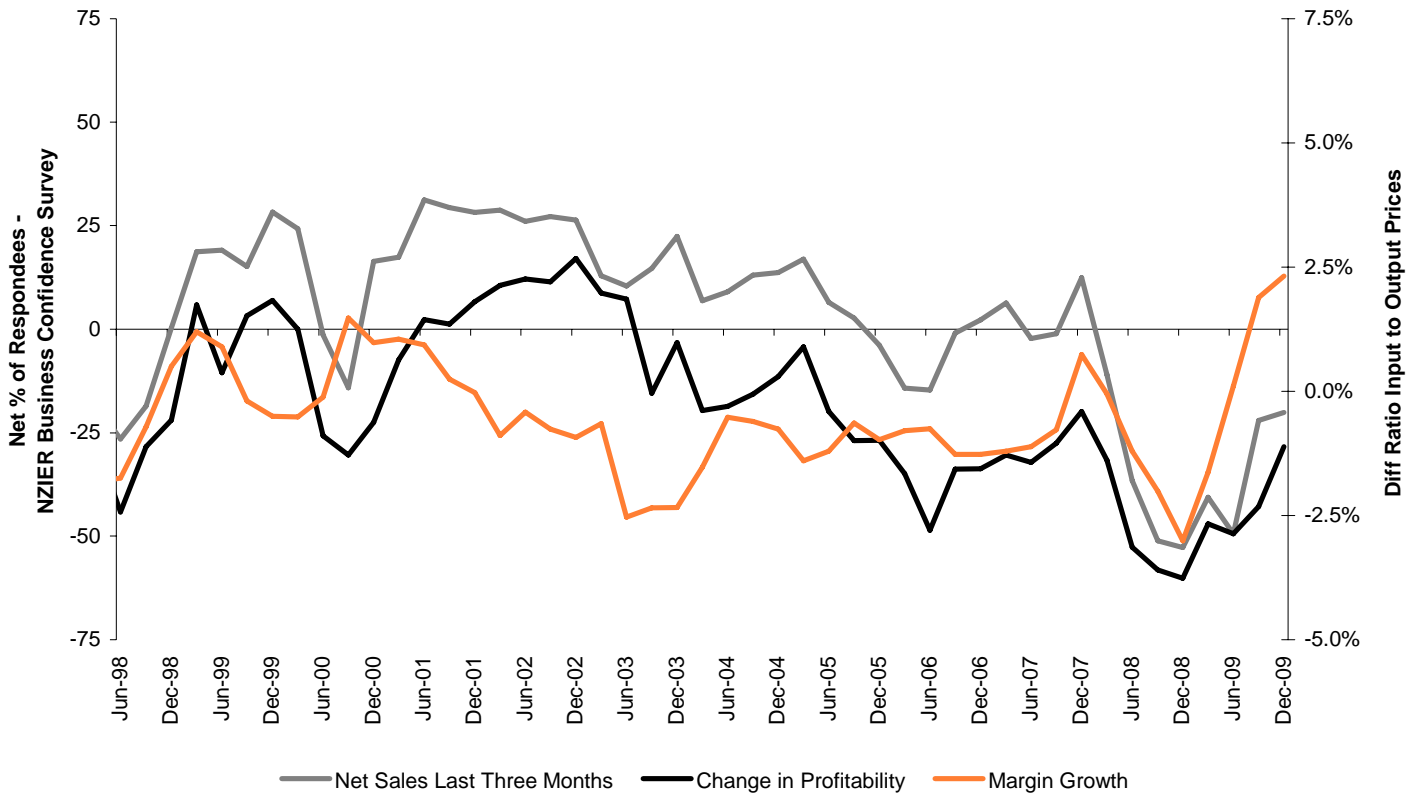
Nationally, the rate of retail sales growth fell very marginally from 2.2% in the year to December 2008, to 2.1% in the year to December 2009. National sales, however, have increased over the last two quarters by 0.4 and 0.1 percentage points respectively.

Consumer confidence in the Wellington region in the December 2009 quarter fell very marginally, down 0.3 points over the September 2009 quarter value - which was its highest level since March 2007. The December 2009 consumer confidence measure of 121.1 means, that for the third consecutive quarter, the number of optimists outweighed the number of pessimists.

Over the last twelve months employment concerns, rising unemployment and increasing interest rates has significantly tempered consumers' appetite for retail spending. At the same time the collapse in new residential building has also impacted retail sales. Retail rents have softened over the last eighteen months and all secondary locations and a number of prime locations have, after a significant period of limited or no vacancy, seen vacancy appear.

Figure 2 illustrates the trend in retailer’s net sales and profitability expectations over the past 3 months, together with margin growth achieved within the retail sector since 1998.

Figure 2: Retailer Expectations for Sales and Profitability, and Margin Growth Trends



Source: NZIER

Retailers have been more positive about net sales and profitability over the last two quarters than they have been for a year and a half. Retailer’s margin growth, measured as the difference between the growth in input and output costs, has continued its recent positive trend and delivered the third consecutive positive result in the December 2009 quarter, the best result recorded in over ten years, indicating a significant focus by retailers on costs over this recent 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 Dec 2009 Year)	Dec-06	Dec-07	Dec-08	Dec-09
Food Retailing	1,730.70	5.7%	-4.5%	-1.2%	2.2%
Supermarkets	15,259.00	6.3%	7.4%	6.6%	6.0%
Footwear	462.40	12.7%	10.8%	4.9%	2.4%
Clothing & Softgoods	2,615.30	3.1%	6.3%	-0.5%	1.4%
Furniture & Floor Coverings	1,267.80	3.8%	6.9%	-12.1%	-11.1%
Appliance Retailing	2,565.70	3.5%	5.1%	-2.1%	3.4%
Hardware	1,441.40	5.6%	14.0%	-3.5%	-3.1%
Chemist	1,872.10	6.3%	4.3%	2.9%	1.8%
Department	3,722.90	3.6%	5.2%	2.0%	-3.0%
Recreational Goods	2,382.60	2.9%	7.1%	-2.9%	4.3%
Accommodation, Hotels & Liquor	3,781.00	3.4%	6.2%	2.7%	-1.8%
Cafes, Restaurants & Takeaways	5,272.50	8.2%	6.5%	1.8%	3.2%
Other	1,788.40	9.0%	4.4%	3.8%	0.5%
Personal & Household Services	235.10	11.5%	4.2%	-8.1%	3.6%
Sub Total (Ex Motor Vehicles)	48,906.50	5.2%	6.1%	2.2%	2.1%
Motor Vehicle Retailing	12,748.60	1.3%	6.9%	-0.4%	-12.8%
Motor Vehicle Services	3,473.30	3.7%	3.9%	-1.0%	0.9%
Total	65,128.40	4.2%	6.2%	1.4%	-1.3%

Source: Statistics New Zealand

In the year to December 2009 the majority of all store type categories experienced positive growth with 'Supermarkets' and 'Recreational Goods' experiencing the strongest growth rates, up 6.0% and 4.3% respectively. Sectors to show the most significant declines in growth included motor vehicle retailing (-12.8%) and furniture and floor coverings (-11.1%).

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:

- A 0.87 hectare site on the corner of Tasman, Rugby and Belfast Streets has been cleared in preparation for development. Foodstuffs are proposing a 2,675 square metre fresh food focussed New World supermarket, an adjoining two level café overlooking the Basin Reserve, three commercial tenancies, 147 carparks and 22 apartments;
- DNZ, owners of the Johnsonville Shopping Centre propose a comprehensive redevelopment and expansion of the existing centre including integration with a transport hub and an upgrade of the existing railway station. This project is currently in planning with resource consent secured in 2009;
- A \$17 million redevelopment of Coastlands Mall, located in Paraparaumu, is underway. 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; and
- Progressive Enterprises proposes to build a new 4,402 square metre Countdown supermarket at the intersection of Adelaide Road, John and Hanson Street. The complex will also include four smaller shops on the ground floor, a café and undercover parking for 236 cars.

A number of other proposed developments are unlikely to proceed in the short term. Typically this is a result of the change in financial circumstances of the developer.

Leasing Activity

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

Table 2: Retail Gross Rents

Location	Typical Rental Range (\$Gross psm)	
	March 2009	March 2010
Prime Lambton Quay	\$2,100 - \$2,400	\$2,100 - \$2,400
Featherston Street	\$800 - \$1,100	\$750 - \$1,000
Willis Street	\$750 - \$1,500	\$650 - \$1,400
Courtenay Place	\$700 - \$975	\$700 - \$975

Source: Darroch Research

CBD retail gross rentals have declined in Willis Street over the last year and a quarter, whilst prime Lambton Quay and Courtney Place rentals have remained stable. 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: CBD Retail Leases and Reviews

Address	Tenant	Date	Total Area	Rental Range (Gross psm)
The Terrace				
111 The Terrace	Finishing Touch Nail Spa (RR)	Jun-09	60	\$300 - \$350
155 The Terrace	Kiwibank (NL)	Feb-09	178	\$215 - \$315
Cuba Street / Courtenay Place				
34 Cuba Street	Fashion Retailer (NL)	Mar-10	45	\$1,250 - \$1,350
148-152 Cuba Street	Comrads (NL)	Feb-10	133	\$600 - \$700
89 Courtenay Place	Shadz Hair Art Limited (NL)	Nov-09	65	\$700 - \$800
132 Courtenay Place	Electric Avenue (RR)	Jun-09	94	\$900 - \$1,000
136-138 Cuba Street	EspressoHolic (NL)	Jun-09	200	\$350 - \$450
55 Courtenay Place	Burger King (RR)	May-09	135	\$830 - \$930
Lambton Quay				
256 Lambton Quay (1 st Floor)	Frangipani Beauty Care (NL)	Sep-09	101	\$300 - \$400
256 Lambton Quay	RYOS (RR)	Aug-09	52	\$2,450 - \$2,550
142 Lambton Quay	Nail Care (NL)	Jun-09	60	\$1,300 - \$1,400
218 Lambton Quay	Amazon (RR)	Apr-09	89	\$2,185 - \$2,285
Willis Street				
212 Willis Street	The Costume Company (NL)	Sep-09	175	\$150 - \$250
124 Willis Street	Wellington Dentists Limited (NL)	May-09	152	\$700 - \$750
100 Willis Street	Maggie Potter (NL)	Nov-08	74	\$1,250 - \$1,350

Source: Darroch Research

RR = Rent Review NL = New Lease

Investment Market

Over the last six months there have been few major retail investment sales. Recent retail investment sales include:

- Parker Fergusson Building, 278-280 Thorndon Quay, Wellington was sold in December 2009 for \$3,230,000 at a yield of 8.3%. The building has a floor area of 1,326 square metres and is leased to Millie Retail Limited;
- A ground floor unit at 227 Cuba Street, Te Aro was sold in December 2009 for \$955,000 at a yield of 8.2%. The unit is 173 square metres;
- Zibibbo Building, 25-37 Taranaki Street, Wellington was sold in October 2009 for \$2,050,000 at a yield of 7.9%;
- Capital on Quay, 256 Lambton Quay, Wellington was purchased by Wilmshurst Properties in August 2009 for \$25,650,000 at a yield of 7.3%. Originally only the two level shopping complex at the base of the building was to be sold, however, Wilmshurst Properties in the end purchased the whole building;
- A retail unit in The Whitaker Building at 136 Willis Street, Wellington sold in April 2009 for \$1,590,000 at a yield of 6.2%. The unit is 284 square metres and is leased to Bello; and
- Churchill Drive Shopping Centre, 124 Churchill Drive, Crofton Downs sold in March 2009 for \$6,000,000 at a yield of 9.8%. The shopping centre comprises nine specialty stores and a Woolworths supermarket, there is also a standalone building which is part of the complex (formerly a Pizza Hut restaurant).

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 December 2009	NZ CBD Office	NZ Industrial	NZ Retail
1 Year	-9.8%	2.4%	-1.3%
2 Years	-1.9%	3.6%	-1.2%
5 Years	11.8%	11.8%	10.7%
10 Years	10.0%	11.5%	11.5%

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 24 months, retail returns had achieved in excess of 10% over the last five years. The CBD office market has under performed both the retail and industrial sectors in terms of annual returns, whilst the industrial market is the only property category to maintain positive returns over the last 2 years. Typical yields for retail property have remained relatively stable over the past year, ranging between 7% and 9.5%.

Market Outlook

The outlook for the retail sector 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 sales growth over the last five or so years have weakened substantially with households, particularly those with high debt levels and / or employment uncertainty reducing discretionary spending. This has resulted in ongoing weakness in retail sales growth, especially for 'large ticket' items. The impact of this much weaker sales growth is already evident with an increase in vacancies in many secondary retail locations and more recently prime retail locations.

Over the short term, lower interest rates, lower inflation and stronger migration will provide some support for the retail sector as will a forecast increase in new residential building. However, offsetting this will be ongoing labour market weakness and a fragile economic recovery.

Demand for lower value well leased retail properties continues to out strip supply. This trend is likely to support the current level of yields in the short term even though it appears this sector of the market appears over sold. Yields may come under some upward pressure in the medium terms if interest rates increase in line with market expectations over the next two years.

For more information,
please contact:

Darroch Limited
Level 10
State Insurance Tower
1 Willis Street
PO Box 1545
Wellington NZ
Tel: +64 (0)4 472 3529

www.darroch.co.nz

Contacts

Key Wellington Contacts

Consulting and Research

Ian Mitchell
+64 (0)4 460 3857
ian.mitchell@darroch.co.nz

Property Services

Murray Stevens
+64 (0)4 472 3529
murray.stevens@darroch.co.nz

Sales and Investments

DTZ New Zealand Limited MREINZ
Licensed Real Estate Agent (REAA 2008)
Kevin Richards
+64 (0)9 374 6621
kevin.richards@dtz.co.nz

Valuation

Wayne Nyberg
+64 (0)4 460 3810
wayne.nyberg@darroch.co.nz

Plant and Machinery Valuation

Tony Pratt
+64 (0)4 460 3820
tony.pratt@darroch.co.nz

New Zealand Office Contacts

Auckland

John Darroch	+64 (0)9 374 6613	john.darroch@darroch.co.nz
--------------	-------------------	----------------------------

Wellington

Milton Bevin	+64 (0)4 460 3853	milton.bevin@darroch.co.nz
--------------	-------------------	----------------------------

Christchurch

Lance Collings	+64 (0)3 363 5044	lance.collings@darroch.co.nz
----------------	-------------------	------------------------------

Disclaimer and confidentiality clause

Every effort has been made to ensure the soundness and accuracy of the opinions, information, and forecasts expressed in this report. Information, opinions and forecasts contained in this report should be regarded solely as a general guide. While we consider statements in the report are correct, no liability is accepted for any incorrect statement, information or forecast. Darroch disclaim any liability that may arise from any person acting on the material within. Readers should take professional advice from a member of Darroch prior to acting on any matter contained in this report.

All Rights Reserved. No part of this work can be reproduced or copied without prior permission in writing from Darroch Limited.

© Darroch Limited *in international alliance with DTZ*