

# Retail Strip Market Link Sydney



## Introduction

Weaker retail sales growth over the past 12 months, coupled with increased competition from larger retail property owners, has limited the performance of the strip retail market within Sydney. At the same time however, lower entry prices and increased liquidity has somewhat insulated this sector from the valuation write downs, witnessed in other retail markets as a result of the GFC. The strong performance however, has been limited to prime properties and selected well positioned secondary properties.

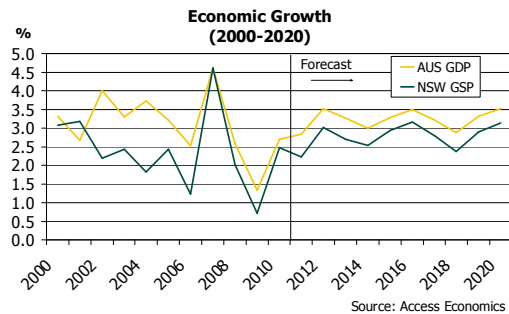
For the purpose of this report, we have reviewed the performance of retail strip properties across the greater Sydney region. To provide the reader with a greater understanding of the market dynamics concerning a current or upcoming investment, this report analyses the conditions of the prime and secondary retail strip markets, in seven sub-regions across Sydney.

## Economic Conditions

### Economic Growth

The Australian economy grew in the December quarter of 2010, with quarterly economic growth rising from 0.1% in the September quarter to 0.7% in the three months to December. Much of the rise in economic growth has come as a result of an increase in non-farm commodity exports. The release of the results in March did however, come with a warning from the Australian Treasury Department, with lower output over the Jan-March quarter expected as a result of the Queensland floods.

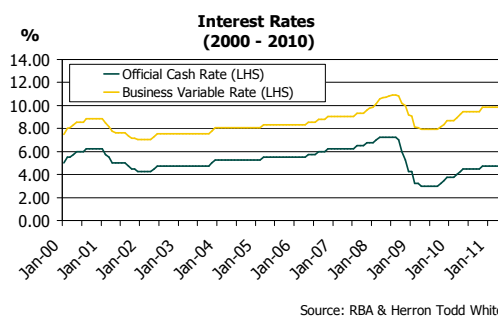
As opposed to other states, the New South Wales economy has a greater exposure to the finance and professional service sectors, compared to the mining and resource based states. As such, economic growth within the NSW economy has under performed the Australian economy since the onset of the Global Financial Crisis in early 2008.



In the 12 months to June 2010, the NSW economy grew at a rate of 1.71% compared to the Australian economy, which grew by 3.0% over the same period.

### Interest Rates

With the RBA seemingly more confident on inflation following the increase in interest rates from 4.50% to 4.75% in November 2010, the RBA has left interest rates on hold in its last five meetings in December, February, March, April and May.



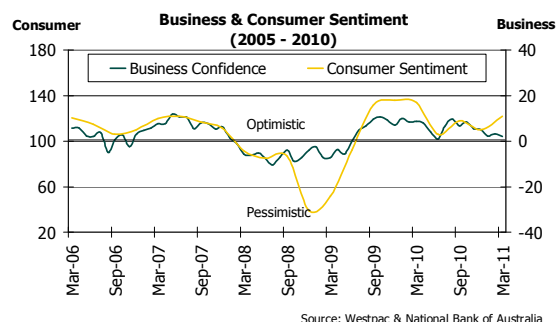
Despite the substantial increase in headline inflation recorded in the first quarter of 2011, the Reserve Bank of Australia ('RBA') has elected to focus on underlying inflation and leave interest rates on hold. The RBA has noted that the recent increase in CPI is reflective of the production losses associated with Cyclone Yasi and the summer floods. The Reserve expects that these price shocks will dissipate over the coming months, steering inflation close to the RBA target rate over the coming 12 months. The RBA, however, has noted that while higher exchange rates are helping to hold back price growth of some consumer items, over the longer term, inflation is expected to come close to its target rate in the year ahead.

### Business and Consumer Sentiment

Business confidence levels are a key lead indicator of future spending and economic growth. After recording a notable fall in the December quarter, business confidence rebounded in the March quarter, rising by 6 points. Much of the improvement in confidence came as the worst of the flood impacts receded. On a monthly basis, business confidence has fallen sharply in the retail, construction and manufacturing sectors, but has risen in the finance/business/property sectors. Improving business confidence has the potential to drive demand for office accommodation, as businesses seek to take advantage of a perceived improvement in business conditions.

The most recent Consumer Sentiment Survey has indicated a slight rise in consumer sentiment following the fall in sentiment in March. As of April 2011, the consumer sentiment index stood at 105.3 points. According to the Westpac/Melbourne institute, this rise in sentiment has come as a result of a stronger economic outlook, interest rate stability and record high exchange rates. Confidence, however, has been constrained by the tragic events in Japan, unrest in the Middle

East/North Africa and significant increases in petrol prices.



Despite this improvement in consumer confidence, retail turnover and subsequently retail rents are expected to remain subdued, as record household savings continue to limit retail sales growth.

### Retail Sales

Retail sales statistics act as a strong leading indicator as to the strength of the retail property market. As shown in the chart below, with the exception of 2008, NSW retail sales have maintained consistent levels of growth from 2000-2011.



While retail sales growth has remained positive over the past 12 months, the rate of growth has slowed substantially as consumers forego purchases in favour of increased savings. Over 2010, retail sales grew by 2.3%, down from 4.3% recorded in the 12 months to December 2009.

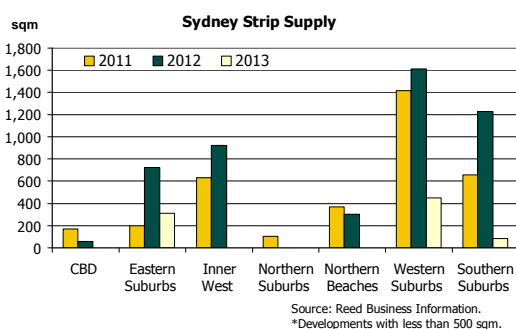
## Market Conditions

Conditions within the Sydney retail strip market remain highly fragmented, with well located prime and secondary properties in high demand, whilst secondary and some traditional prime strips feel the impact from increased competition. Despite the increased competition from larger enclosed centres, continued demand from independent retailers has helped to boost the performance of several prime and secondary retail locations within Sydney.

Market conditions, however, remain weak in suburban locations featuring a nearby regional or super regional centre, as increased competition limits the demand for space outside of these centres.

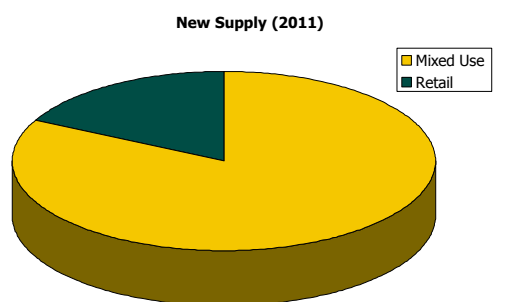
### Supply

Over the 12 months to January 2012, some 3,547 sqm of strip retail floor space will be added to the market (defined as space under 500sqm). Reflecting the greater trend within both the retail and residential markets, the majority of this space is located within mixed use developments.



As shown in the chart above, the Western Suburbs and the Inner West will account for the greatest proportion of new supply. Following 2011, the rate of new supply will increase slightly with some 4,845 sqm of new strip retail space added to the Sydney Market.

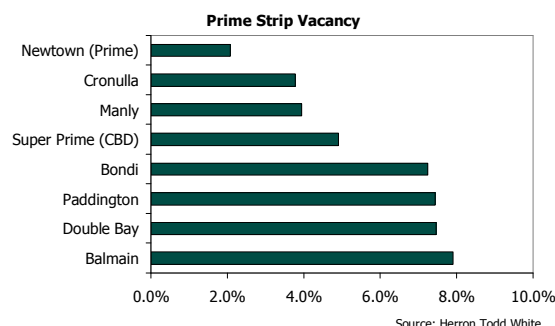
Due to the nature and location of many of these developments, it is unlikely that this increase in supply will have a significant impact on vacancy rates within existing retail strip locations.



As shown in the chart above, only 17.4% of 2011 supply consists of stand alone retail development.

### Occupier Demand

Reflecting the shift in occupier preferences, demand for retail space in prime locations is being driven by independent retailers, with larger national/international retailers showing preference for regional and super regional centres. Over time, this has seen a shift in the performance of Sydney's traditional prime locations, with vacancy rising above 7% in Balmain, Double Bay and Paddington.



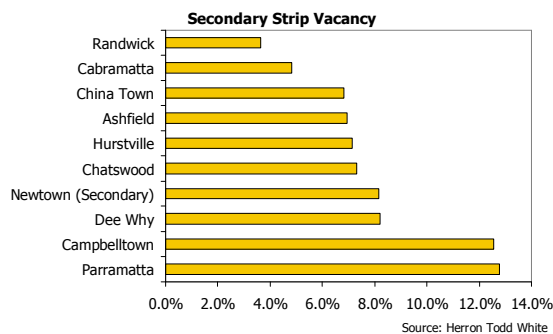
It can be seen in the chart above that vacancy is lowest in Newtown and Cronulla. A review of the occupier types within these locations revealed a

### Selected Retail Completions 2011-2012

Building Address	Suburb	Retail Size (sqm)	Comments
128 Waterloo Road	Greenacre	400	Construction of five shops featuring a upper floor residential suite.
508-510 Marrickville Road	Dulwich Hill	300	Mixed use development featuring six residential units and two retail suites.
30A Hastings Parade	Bondi Beach	40	Four storey mixed use development featuring one retail suite.
90 The Corso	Manly	50	Expansion of the former Crystals restaurant to allow for upper level retail uses.
107-109 New Canterbury Road	Petersham	162	A three/four storey building featuring two retail suites.
19A-21 Northumberland Street	Liverpool	155	A 40 unit residential development featuring two retail suites.
14-24 College Street	Darlinghurst	129	Adaptive reuse of existing commercial building for residential purposes featuring a single retail suite.
79 Rooty Hill Road	Rooty Hill	100	Mixed use development featuring 15 units and a single retail/commercial suite.

Source: Reed Business Information, PCA & Herron Todd White

lower proportion of 'chain store' retailers, when compared to the number of independent retailers. The one exception however, is the Manly Corso and Super Prime locations in the CBD which are still favoured by national tenants.



Similarly to the prime market, increased competition from larger enclosed centres is limiting the demand for secondary strip retail space. This lack of demand is most prevalent in the Western Suburbs, where a lower quality of strip retail space, coupled with increased competition, has placed upwards pressure on vacancy rates. In Parramatta and

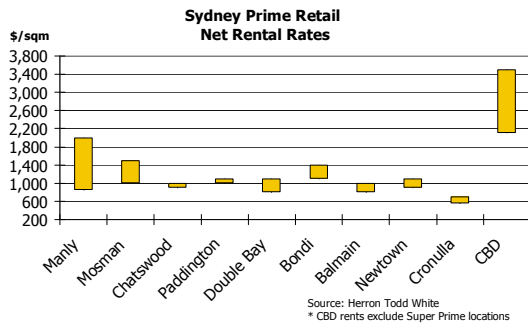
Campbelltown, vacancy was above 12% as at May 2011.

A review of vacancy across the Sydney retail market revealed that strong demand for secondary space originates from ethnic based retailers who seek locations with strong ties to a specific community. As shown in the chart adjacent, vacancy remains low in Cabramatta, China Town, Ashfield and Hurstville, with retailers having a specific desire to be located in these markets. This demand however, is highly location specific and is generally not transferable between neighbouring markets.

### Leasing Market Conditions

Reflecting the weaker retail turnover, retail rental rates in all markets have recorded minimal growth in the 12 months to March 2011. The exception however, has been super prime and prime CBD properties which have recorded a 4%-7% increase in net rental rates over this time. Outside of the

CBD, increased competition from larger enclosed centres has placed pressure on strip rental rates, with minimal demand from larger national/international retailers, for retail strip locations.



In the CBD, demand for retail space remains high within the 'Prime Quadrangle' with the re-opening of Westfield Sydney, seemingly boosting the demand for space within this precinct. Rental rates for properties within this location can be as high as \$13,000/sqm, depending on location and frontage of the property.

As shown in the chart above, prime CBD retail properties command a significant rental premium, compared with prime properties located outside of the CBD. Outside of the CBD, rental rates for prime retail properties range between \$800/sqm and \$2,000/sqm, with properties featuring frontage to Manly Corso attracting the highest premium. With the exception of Newtown, prime rental rates have come under pressure within Sydney, as increased vacancy, coupled with lower consumer spending limits rental growth.

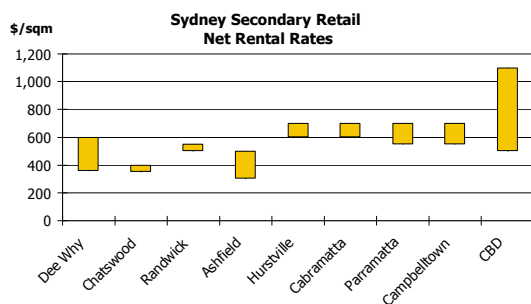
Unlike the prime market, demand for secondary retail properties within Sydney is relatively limited. Demand and subsequently rental rates vary significantly between and indeed within secondary retail locations. As shown in the chart above, net rental rates for secondary properties within Sydney range between \$350/sqm and \$700/sqm, exclusive of secondary CBD properties which range between \$500/sqm and \$1,100/sqm.

## LEASING ANALYSIS



<b>Address:</b>	Shop 1, 255 Pitt Street Sydney
<b>Property:</b>	A prime retail property with a 7.5 metre frontage to Pitt Street.
<b>Rental:</b>	\$550,000 (gross)
<b>Start Date:</b>	24/12/2010
<b>Floor Area:</b>	155 sqm
<b>Lease Term:</b>	5 Years
<b>Reviews:</b>	4% annual reviews
<b>Incentives:</b>	5%
<b>\$/sqm:</b>	\$3,548 (gross)

Caution, however, must be taken in the interpretation of these results, as rental rates for older, less exposed retail properties can be significantly lower than average rates for the retail market where the property is located.



Source: Herron Todd White

As shown in the table below, rental rates range significantly within sub-markets with demand varying significantly between differing levels of quality.

#### Secondary Suburban Net Rental Rates

Sub-Market	Upper (\$/sqm)	Lower (\$/sqm)
Eastern Suburbs	500	300
Inner West	425	225
Northern Beaches	800	500
Northern Suburbs	700	400
Southern Suburbs	700	550
Western Suburbs	700	550

Source: Herron Todd White

#### Investment Market Conditions

Demand for retail investments remains highly fragmented, with prime properties featuring strong lease covenants benefiting from the highest demand, while secondary properties, or properties with lower quality tenants, remain out of favour with both investors and owner occupiers.

## LEASING ANALYSIS



**Address:** 1a/1 Mona Vale Road  
Mona Vale

**Property:** A ground floor retail suite in a recently completed mixed use development, featuring shared parking.

**Rental:** \$96,000 (gross)

**Start Date:** 01/02/2011

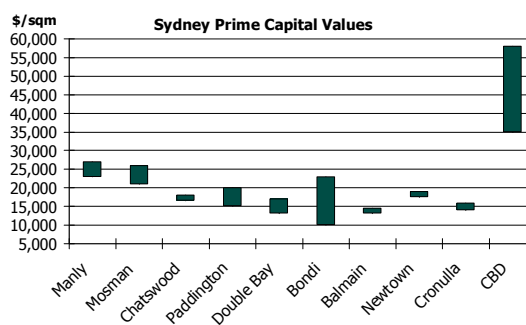
**Floor Area:** 210 sqm

**Lease Term:** 2 Years

**Reviews:** CPI

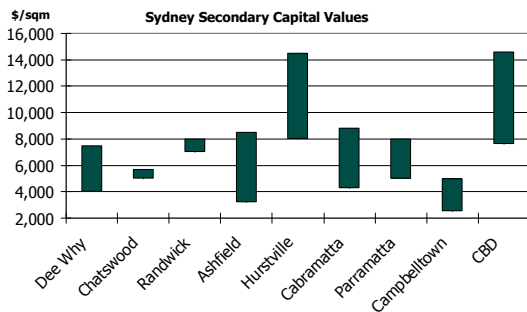
**\$/sqm:** \$457 (gross)

As shown in the chart below, prime and super prime properties within the CBD command a significant price premium to prime retail properties located outside of the CBD.



Source: Herron Todd White

Across the broader Sydney region, yields for prime retail properties range between 5% and 7% dependent on the quality of the existing tenant. As shown in the overleaf, beachside locations command the highest capital values, as a limited supply of properties, coupled with higher rental rates, place upwards pressure on capital values. Elsewhere in Sydney, capital values in traditional prime locations such as Double Bay and Balmain have come under pressure, as investors re-assess the vacancy risk associated with these locations.



Source: Herron Todd White

In the secondary market, capital values are subject to a greater level of variability, with demand from both investors and owner occupiers differing significantly from location to location.

#### Secondary Suburban Capital Values

Sub-Market	Upper (\$/sqm)	Lower (\$/sqm)
Eastern Suburbs	10,000	6,000
Inner West	8,500	6,000
Northern Beaches	5,000	2,500
Northern Suburbs	10,000	5,800
Southern Suburbs	8,500	3,200
Western Suburbs	7,100	3,500

Source: Herron Todd White

As shown in the adjacent chart, retail properties in Hurstville attract the highest capital values, driven predominantly by a high presence of owner occupiers. Capital values for properties within Hurstville range from \$8,500/sqm- \$14,500/sqm.

Demand from owner occupiers and investors remains highly location specific. A review of recent secondary sales revealed that demand is highest for properties which do not directly compete with enclosed centres. Caution, however, must be taken when reviewing a secondary property, with demand almost non-existent in some older, less exposed properties.

## SALES ANALYSIS



**Address:** 454 Princes Highway, Rockdale

**Details:** A older style attached strip retail building, featuring three upper level office suites.

**Sale Price:** \$800,000

**Sale Date:** 16/12/2010

**Building Size:** 330 sqm

**\$/sqm:** \$4,250

**Yield:** 6.07%

## Market Outlook

Mimicking the conditions over the last 12 months, the performance of the Sydney retail strip market will remain highly fragmented, as lower retail sales growth limits the demand for retail space within Sydney.

In the prime market, we expect that vacancy will continue to rise in traditional locations including Paddington, Balmain and Double Bay, as strong competition from larger centres limits the demand from national tenants, while independent retailers remain in favour of alternate locations. Reflecting this divergence, we expect that demand will remain high for prime retail properties in Newtown and Cronulla, with these markets benefitting from stronger demand from independent retailers.

In secondary locations, occupier demand will remain depressed, as weaker retail sales growth limits the establishment of retail start ups and the expansion of low to middle range retailers.

Reflecting the uncertainty within the rental market, demand for retail strip investment properties will remain weak over 2011, as investors remain wary of the income security offered by retail strip investments. Despite this lack of investor demand, yields are not expected to soften significantly, as vendors remain unwilling to accept higher yields.

## Further Information

For a more in depth understanding of the current retail market conditions and how they relate to your property, or for further information regarding any Herron Todd White service, please contact either:

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