

AROUND THE BLOCK

THIS WEEK OUR TEAM EXPERTS EXAMINE NEIGHBOURHOOD SHOPPING CENTRES



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WHERE ARE WE IN THE CYCLE FOR NEIGHBOURHOOD SHOPPING CENTRES?

IN relation to pricing, I think we are at 9 to 9.30 o'clock for metropolitan and 5 to 7 o'clock for regionally located and country centres. We are still a couple of hundred basis points behind Victoria.

IT'S difficult to predict. Low bond yields are making neighbourhood centre yields look attractive. The bond yields are low due to patchy economic conditions here and globally which is evidenced by a challenging retail leasing environment. Caution needs to be exercised when assuming yields will continue to fall.

THE retail market is in a mature phase, however with limited quality investment opportunities available in other sectors we are noticing new lines of capital in the market. This is due to the sector's defensive investment characteristics and strong fundamentals, a trend expected to continue while debt remains low.

DESPITE a minor downswing at the start of the GFC, the shopping centre cycle has been on a steady rise ever since. They are in limited supply with existing owners reluctant to sell unless there are alternative projects in which they can invest in. So in cycle terms we have been in the 9 to 11 o'clock period for quite some time.

WHO IS IN THE MARKET TO BUY AND WHY?

A NUMBER of the bigger players are out of the market because they cannot see value. Most, but not all, of the buyers are new to the market and are not pricing the risk. The yield on retail centres is being driven down because of the low interest rates and lack of alternatives.

RESILIENCE is the hallmark of the sector with its high exposure to non-discretionary spending from grocery, medical and services. The most active investors remain high net worth privates and the 3 sector specific funds. Despite immediate challenges, we have a long term belief in the sector.

ACTIVITY across the retail sector has been dominated by interest from private HNWs, medium size funds and offshore capital. These groups are the most aggressive among the current pool of purchasers as they are able to adapt quickly to the moving market conditions and are not restricted with a high IRR hurdle.

THERE is a common misconception in the market that our shopping centres are all being sold off to foreign investors, however the opposite is happening. I would estimate that in excess of 90 per cent of retail centres are being sold to local investors.

COMPARED TO TWO YEARS AGO HOW MUCH HAVE YIELDS TIGHTENED?

FOR quality centres we have seen yields come back from about 8 per cent to under 6 per cent. A couple of years ago we were not seeing many new centres being developed because of the GFC. We are now seeing a lot of new centres being developed in growth areas. The surge in new housing is driving this development.

MINIMUM 150 basis points over the past 24 months for A-grade centres with minimal leasing risk. B-grade assets may show yield compression in 2017 but lenders are cautious around leasing and development risk which may temper this somewhat.

WE have seen a gradual firming of yields, driven by the low cost of debt, limited opportunities and a weight of capital. Over the past 24 months, I'd suggest we have seen yield compression of between 125 and 150 basis points. These levels are firmer than the pre GFC peak.

YIELDS have tightened approximately 0.5 percentage points a year over the past two years. Despite many experts stating that the market has topped out, we are continually experiencing record low yields as new centres come onto the market. For example, a centre that was worth \$20 million two years ago is now worth \$23 million.

WHAT IS HAPPENING IN THE REGIONS?

NEW centres are selling well, again without appropriate pricing of risk. Older centres are still providing opportunity. The mining towns and regions are still waiting for a recovery.

REGIONAL economies have begun to stabilise post the retreat in capital expenditure in the mining sector and a recovery in commodity prices. Recent transactions suggest regional yields are now converging toward those being achieved in metropolitan areas.

WE have noticed strong yield compression for regionally based neighbourhood centres off the back of limited stock availability in metropolitan locations. The yield gap between metropolitan and regionally located assets is closing as purchasers are being forced to consider alternative options.

WITH quality retail stock difficult to find, investors are comfortable with investing in regional and country located centres. In many instances a quality country shopping centre with a Coles or Woolworths supermarket may offer better security than its urban counterparts.

WHERE DO YOU SEE THE SECTOR IN FIVE YEARS?

I WOULD not like to make a call for five years out given some of the issues such as out of control sovereign debt. We have seen this increase worldwide sevenfold since 2007 and something must give. I am just not a buyer at current prices, I am a seller.

THE demand for stable returns with a natural hedge against inflation will see the sector enjoy continued capital inflows. Improving retail formats/offers will be exciting for the sector as retailers look to please an increasingly discerning shopper whose habits are changing and have a lot more choice.

THE five-year forecast will depend on the macro outlook. There is considerable global volatility at present, which means that the current low growth environment is likely to continue. The real barrier to prevent further yield compression will be how financiers negotiate debt options.

IT is a simple case of supply and demand. Very few new shopping centres are being developed and there is a huge volume of unsatisfied demand. With a combination of a long term, low interest rate cycle, and considerably higher yields than those being achieved overseas, we are likely to continue to experience record sale prices for quite some time.