



# A review of the Australian retail sector

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# Authors and contributors



**Jennifer Johnstone-Kaiser**

**Principal Consultant, Head of Property**

Jennifer leads Frontier Advisors' real estate research program providing consulting and research for clients, both domestically and globally. Jennifer has significant global experience across the US, Australia and Asia. Previously, Jennifer was the Country Head and Director of Business Development with Savills Investment Management and Mercer's Head of Real Estate - Asia Pacific. Jennifer has worked with a number of Asian and European pension funds, insurers, universities and endowments. She is a frequent presenter at industry conferences.

Jennifer is a Senior Fellow of Finsia. She holds a Master of Finance and Bachelor of Business, Property (Distinction), RMIT.



**Jacqueline Marie Darwis**

**Associate**

Jacqueline Darwis is an Associate in the Real Assets Team focusing on property manager research. Prior to joining Frontier, she was a research analyst at Jones Lang LaSalle's Melbourne office that worked across internal capital markets and valuations teams to produce retail research and consultant reports for clients. Jacqueline has also worked at PPC Urban as a Graduate Analyst generating demand assessments for childcare, medical care and aged care projects across Australia.

Jacqueline holds a Bachelor of Design (Property & Urban Planning double-degree) and a Masters of Property from the University of Melbourne.

# Purpose

## The rationale for the Australian retail sector in client portfolios

### Frontier's starting point and view

- In 2019, prior to COVID-19, we examined the fundamentals of the retail sector, including macroeconomic factors influencing various drivers such as the rise of online shopping. At the time, we anticipated growing pressure on traditional brick-and-mortar retail models.
- Frontier conducted a detailed analysis, including a discounted cash flow assessment across three scenarios: *base*, *downside*, and *upside*.
- Our findings suggested the retail sector was poised for a *prolonged metamorphosis* in the near term.
- As a result, we recommended clients reduce exposure to retail and reallocate towards logistics and needs-based sectors (such as housing, healthcare, life sciences), which are supported by enduring secular trends.

### Recent significant disruptions to retail

- Online shopping: Australian consumers have embraced the convenience of online shopping, though adoption lagged the UK and US due to cultural differences. Traditional brick-and-mortar retailers have struggled to recover lost consumer spending, with department stores particularly impacted by unproductive footprints and declining popularity. Shopping centre managers, however, capitalised by repurposing spaces and securing higher rental yields.
- COVID-19: Lockdowns severely disrupted in-store shopping (excluding supermarkets), though government subsidies masked the full extent of the distress. In response, Australian retailers quickly adapted to multi-channel shopping, significantly improving profitability and occupancy cost ratios.

### Recovery and looking ahead

- Retail was the most defensive and top-performing sector for 25 years. A muted recovery is underway, but positive returns may be challenging in the short-term. Specialist sector funds will come under stress from impending liquidity windows, leading to:
  - Protracted solutions including sale of assets fund wind-downs.
  - Lower equity raising appetite, elevated gearing, need for fresh capital to fund strategic development plans. We expect M&A activity to solve for liquidity.
  - Underlying sector fundamentals point to a positive forward recovery based on low supply; growing population; retailer profitability; and low vacancies.
- Frontier's outlook is more optimistic now than at any time since 2019, with potential upside in the next cycle, albeit within redefined structures. Income yields are projected to remain strong at 4.5%–5%. However, geopolitical and macroeconomic volatility could result in recessionary risks.



Frontier's model portfolio proposes a slight change in long-term allocation for the retail sector, between 15% to 35% (compared to 20% to 40% previously), recognising changes in relevant benchmarks and fundamental pressures from upcoming liquidity windows. If investors can secure liquidity over the next few years, Frontier prefers allocations to cash-yielding strategies such as needs-based sectors.

# Hierarchical factors driving a modest retail recovery in Australia

Critical consideration over the forecast period (ten years)

- Supply is currently well below required per capita as per Australian planning guidelines.
  - Planned developments shelved exacerbating the imbalance in supply.
  - High barriers to entry for large retail assets and lengthy development approval processes materially stall future developments.
- Forecast undersupply will continue to drive rental growth for large retail assets.
  - Landlords are successfully capturing a range of income streams written into contractual lease agreements and improving profitability (capitalising on landlord-friendly opportunities in omnichannel distribution and capturing online sales where orders are fulfilled in-store and/or through drone delivery).
- Australia is forecast to benefit from the second highest population growth of all OECD nations, driven by net overseas migration of working age consumers.
  - Migration intakes are moderating globally. If Australia was also to go down this path population growth may slow. So far, we are seeing a moderation of post-pandemic migration after the bottleneck of migration during COVID-19 lockdowns.
- Forecast GDP growth is broadly similar to OECD nations\*, suggesting relative strength of the Australian economy.
  - *High levels of Australian household debt may curtail retail spending among young families.*
- Many super regional and regional centres have unused land banks (vacant land or carparks). These represent embedded value for multi-use purposes.
  - Some retail managers are more advanced with development plans for mixed-use, higher and better use and re-zoning opportunities.

**1. Imbalance between supply and demand**

**2. Rental growth**

**3. Population growth**

**4. Economic growth**

**5. Land banks**

Source: IMF. \*Forecast 5-yr CAGR for Australian GDP growth is 4.3%, Frontier Advisors



# Future indicators for sector recovery

## Following an extended metamorphosis, early signals of recovery are evident

Retail property has weathered a prolonged period of muted performance but there are promising signs a recovery is ahead. Looking forward, we examine trends and structural fundamentals which could predict a sustained reversal for the retail sector. We will monitor how these could continue to change over time which will inform our assessment of the structural drivers of the sector.

### Demand drivers

Population growth	Growth in multi-channel retailers	GDP growth and demographics	Income and wealth growth	Yield premium to risk-free rate	Consumer sentiment														
<p>The strongest demand driver for retail space is population growth.</p> <ul style="list-style-type: none"><li>Based on experts and research, we believe the required retail space per capita is circa double current levels.</li><li>For example, for supermarkets, ~0.3 square metres per person is considered the benchmark<sup>1</sup>.</li><li>Population growth forecasts suggest future retail space demand will significantly exceed current stock.</li></ul>	<p>A growing number of multi-channel retailers have expanded ‘click &amp; collect’ sales, driving the need to maintain or increase shopping centre space.</p> <ul style="list-style-type: none"><li>JB Hi-Fi satisfies half of all online sales through in-store click &amp; collect.</li></ul> <p>Share of online sales for click &amp; collect</p> <table><tr><th>Retailer</th><th>Share of online sales for click &amp; collect</th></tr><tr><td>Bunnings</td><td>85%</td></tr><tr><td>BCF</td><td>60%</td></tr><tr><td>JB Hi-Fi</td><td>50%</td></tr><tr><td>Woolworths</td><td>40%</td></tr><tr><td>Rebel</td><td>32%</td></tr><tr><td>Macpac</td><td>17%</td></tr></table>	Retailer	Share of online sales for click & collect	Bunnings	85%	BCF	60%	JB Hi-Fi	50%	Woolworths	40%	Rebel	32%	Macpac	17%	<p>Understanding of economic growth and forecasts should be granular for retail.</p> <ul style="list-style-type: none"><li>Which industries within an economy drive retail demand?</li><li>Quantum of this demand and changing nature of demographics offers insight into which retail categories will succeed.</li></ul>	<p>According to the 2023 Intergenerational Report, median household incomes are forecast to rise circa 38% over the ten-year period to 2033.</p> <ul style="list-style-type: none"><li>Millennials and Gen Z are less likely to have mortgages than prior generations, increasing their net disposable incomes.</li><li>Rising interest rates and inflation impact disposable income and can reduce consumer consumption.</li></ul>	<p>Investor demand is affected by the yield premium to long-term bonds. The retail sector has gone through a period of expanding yields.</p> <ul style="list-style-type: none"><li>We are likely entering a lower interest rate period, elevating the yield premium to long-term bonds.</li><li>Investor and occupier risk tolerance impact investment appetite.</li></ul>	<p>Consumer sentiment is directly correlated to consumption levels.</p> <ul style="list-style-type: none"><li>Consumer sentiment has been at or near historic lows, but according to NAB and Westpac data, there are signs of improvement.</li><li>Growing pessimism around economic and employment growth, interest rates, and geopolitical conditions could impact the forward view and dampen consumer spending.</li></ul>
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Source: <sup>1</sup> <https://bit.ly/4idjrRw>, Company reports, MST Marquee

# Potential disruption ahead?

## Looming liquidity windows in Australia's wholesale funds universe



Source: Frontier Advisors, MSCI

### Primary markets

- Frontier actively maps and monitors upcoming liquidity windows.
- 2025 to 2029 could be a watershed period for specialist funds, in particular retail and office funds.
- While we continue to track funds and potential liquidity flows, retail windows could equate to several hundreds of million dollars. This is a fund that previously suffered from 50% redemption requests and took over five years to satisfy (which was completed in 2024).

### Secondary markets

- Frontier actively maps and monitors trades in this segment.
- The level of discounts peaked at circa 20% in 2022.
- We have observed a marked change in sentiment and a contraction in bid-ask spreads in the last two years. Current levels are between 5% to 8% on a deeply adjusted NAV.

# The final word

## Improving outlook over the medium to long term tempered by near term economic uncertainty

### Strong fundamentals

- The Australian sector has largely restructured and repositioned itself post COVID-19. Retailers found a way to capture both online and in-store sales.
- Underlying dynamics have improved with key metric adjustments:
  - Improved immigration, strong employment levels.
  - Supply is at an all time low (per capita levels of retail space can support double the number of retail centres).
  - Current retailer occupancy costs (measure of rent-to-sales) are close to all-time lows, suggesting rents could be increased over time.
  - Retailer occupancy costs (measure of rent-to-sales) rebased post-COVID, suggesting a trajectory for sustainable rental growth going forward.

### Potential headwinds

- Persistent or elevated interest rates and inflation.
  - Cost of living pressures have and continue to curb discretionary spending, including hospitality spending (at restaurants, food courts, bars and supermarkets).
- Rising online sales (currently around 13%).
  - We expect Australian shopping habits are unlikely to match those of the UK, US, South Korea (30 to 40%). Even if this changes in favour of online, retailers have worked out how to capture multi-channel sales. The unknown is the longer term of drone-delivery or other forms of low flying vehicles.
- Future retail investment landscape – small fund sizes with looming liquidity windows pose a challenge for investors and fund managers.
  - All options including fund wind-ups must be considered, to avoid sub-optimal outcomes.



On balance, the sector largely managed the structural shift with government assistance over COVID-19. However, the domestic market's liquidity window headwinds pose some risk as well as opportunities (possible M&A activity which could lead to consolidation of smaller and sub-scale funds). Depending on the risk/return objectives of investors, there may be a range of short- to medium-term outcomes, which should be considered as part of a whole-of-portfolio approach.



Level 17, 130 Lonsdale Street

Melbourne, Victoria 3000

Tel: +61 3 8648 4300

[frontieradvisors.com.au](http://frontieradvisors.com.au)

[@frontier\\_adv](https://www.instagram.com/frontier_adv)

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