



A review of the Australian retail sector

July 2025

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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.

Starting point

2019 retrospective

Frontier observed structural changes on the horizon, including rising online sales, shifting consumer shopping habits and pressure on retailer business models due to disruptions in categories like department stores and apparel.

- We concluded the retail sector would undergo a protracted metamorphosis in the near term.
- Our analysis assumed a period of adjustment (2020 and 2024). We projected the sector would evolve and recover over time although unlikely to recoup the defensive characteristics it held over the past 25 years.
- While transactions (Q4-2019) showed a mild discount there was evidence of a further 10% discount being factored in by valuers over 2020. We said exiting via secondary unit sales would require a significant discount to achieve an effective result.
- We projected a valuation impact on retail funds to be as follows:

	Frontier scenarios		
	Downside	Base case	Upside
IRR	1.2%	3.8%	7.0%
Equity revaluation	-38%	-22%	1%
Five-year return from Mar-20 to Mar-25 (CAGR)	Total: 2.7%, Capital: -2.5%, Income: 5.4%		
Peak (Mar-19) to current capital values	-18.2%		

Clients were reminded of Frontier's 2018–2019 recommendations to reduce exposure to retail and office sectors in favour of logistics and the 'Other' bucket (housing, healthcare/life sciences), which are supported by strong demographic drivers and less affected by macroeconomic volatility.

Scorecard

- In 2019 our base case projected an equity revaluation of -22%.
- The actual peak (March 2019) to current capital values is calculated to be -18.2%. The writedown was close!
- Secondary trades: We assessed fair value to be 15% to 30% discounts to net asset value (NAV). Recorded trades between 2020 and 2023 were up to 22% discount.

Chart 1: Total return index – retail (20-year index)

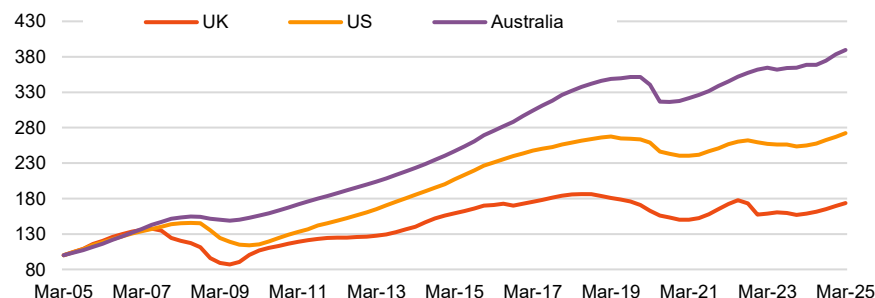
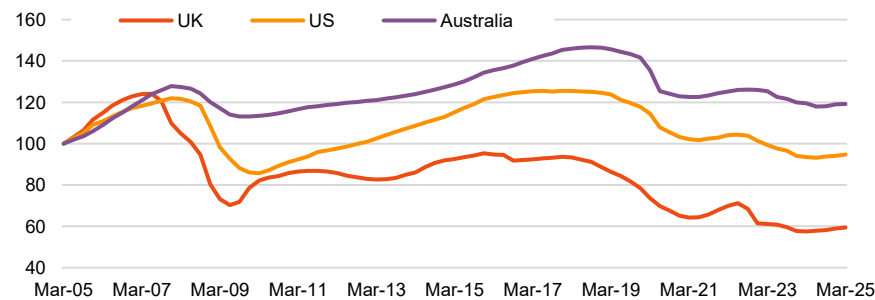


Chart 2: Capital growth index – retail (20-year index)



Source: MSCI, Frontier Advisors

Revisiting drivers of performance

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 car parks). 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

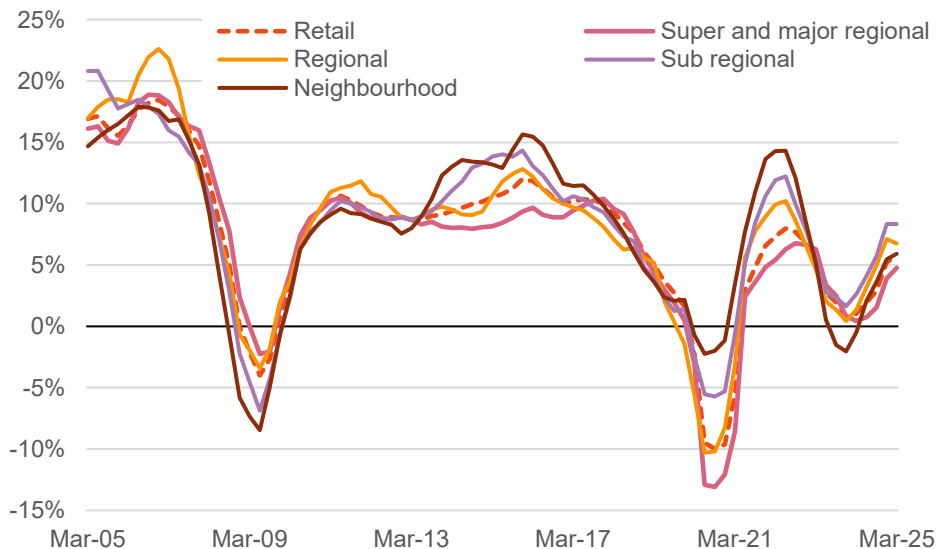
Source: IMF. *Forecast 5-yr CAGR for Australian GDP growth is 4.3%, Frontier Advisors

Performance

Total returns buoyed by strong income growth

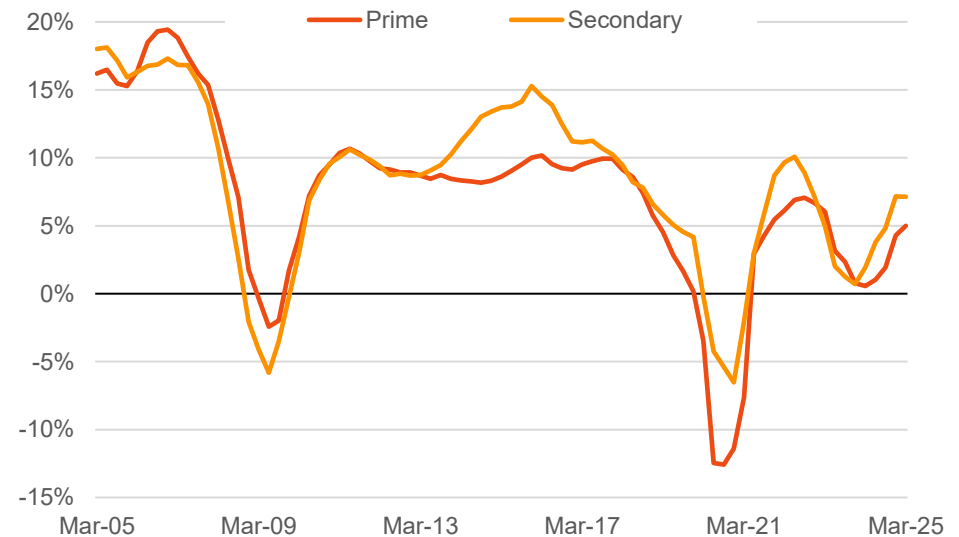
- Retail property return spreads by type (major regional, sub-regional and neighbourhood) have tightened after a period (post-COVID-19) of loosening, according to data provided by MSCI and illustrated in Chart 3 and 4. Total returns of larger assets have rebounded along with investor sentiment.
- Retail performance by quality, location, type and size of asset remains divergent, though convergence is evident.
 - Total returns in secondary assets have been driven primarily by stronger capital growth, as a result of increased activity from private investors and syndicators (over the past 18-24 months).
 - Sub-regional and neighbourhood centres have recorded the strongest returns, particularly in Victoria and WA, according to December 2024 data from MSCI.

Chart 3: Australian retail rolling 12-month total returns by sub-sector (%)



Source: MSCI, Frontier Advisors

Chart 4: Australian retail rolling 12-month total returns by quality (%)



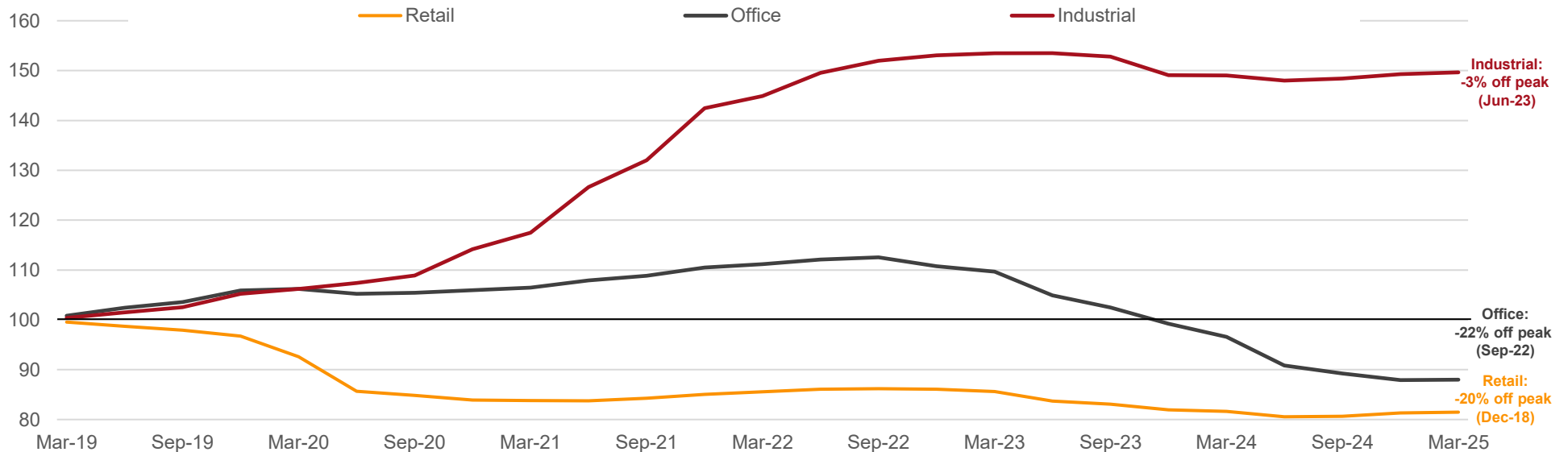
Source: MSCI, Frontier Advisors

Performance

Relativities to other sectors are increasingly attractive

- Retail capital values peaked in December 2018. Since then, retail capital values remain circa 20% below peak values.
 - COVID-19 was not the actual disruptor for the repricing in the retail sector.
 - In comparison, office values are circa 22% below September 2022 peak values.
- Investors are also starting to revise their pricing expectations for retail assets, as illustrated in Chart 5.
 - With the exception of Sydney and Melbourne industrial, Sydney retail now has the tightest gap between buyer and seller expectations on pricing.

Chart 5: Capital value indices by property sectors (indexed to Dec-18)



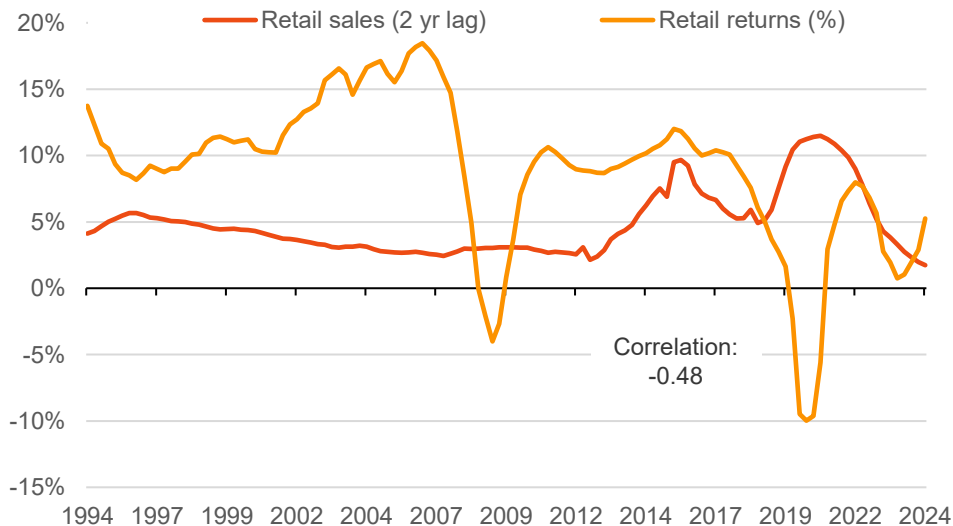
Source: MSCI, Frontier Advisors

Performance

Improved retail sales and low occupancy costs should benefit retail landlords in the medium term

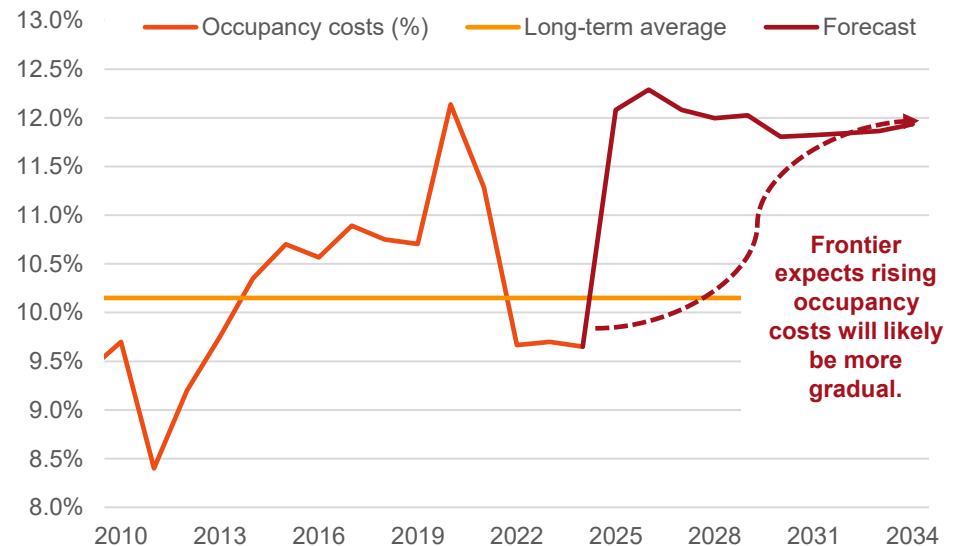
- There is a lagged effect between retail returns in the real estate sector and retail sales, as shown in Chart 6. Rapidly rising retail sales don't directly translate to higher returns for retail landlords and retail property investors immediately. While not the strongest predictor for retail sector property returns, stronger retail sales generally have a positive effect on future rents.
- After rising to record high levels just before the COVID-19 pandemic, occupancy cost ratios (OCRs) fell sharply during country-wide lockdowns and are now lower than they have been for quite some time. As moving annual turnover (MAT) and productivity rebounded strongly following the pandemic, rents have not kept pace. *Frontier believes there is potential for rents to be increased over the near term in a measured way.*
 - Retailers recorded strong sales over the past four years. Retailers benefited from rent moratoriums and minimal contracted rent rises during COVID-19.
 - Urbis reports sub-regional centres were the only asset types to experience an increase in OCRs year-on-year. OCRs for CBD centres continued to fall to 16.4% in 2024, from 17.6% in 2023.

Chart 6: Australian annual retail sales (two-year lag) versus annual retail property returns



Source: MSCI, ABS, Frontier Advisors

Chart 7: Occupancy costs (%)



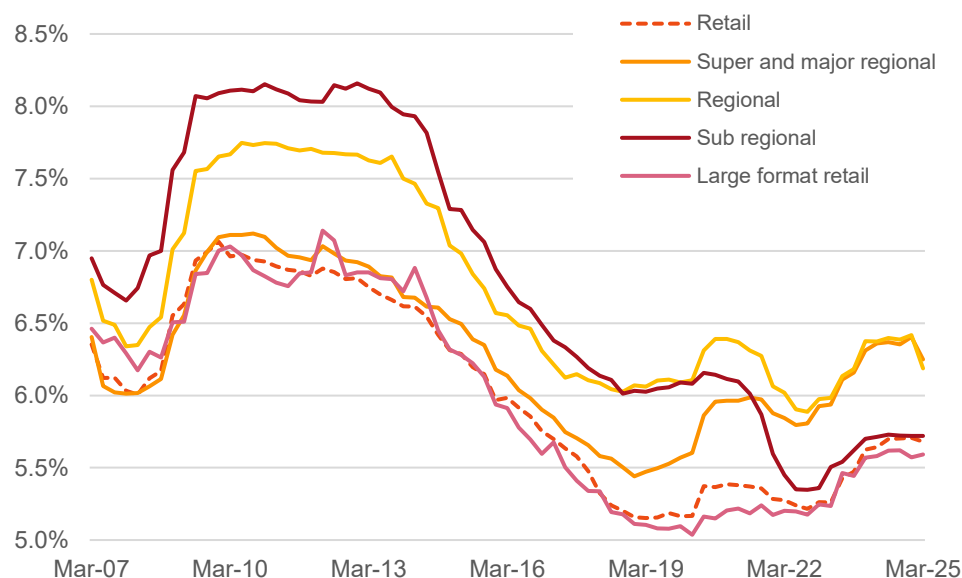
Source: Manager surveys, Frontier Advisors

Valuations

Cap and discount rates trends

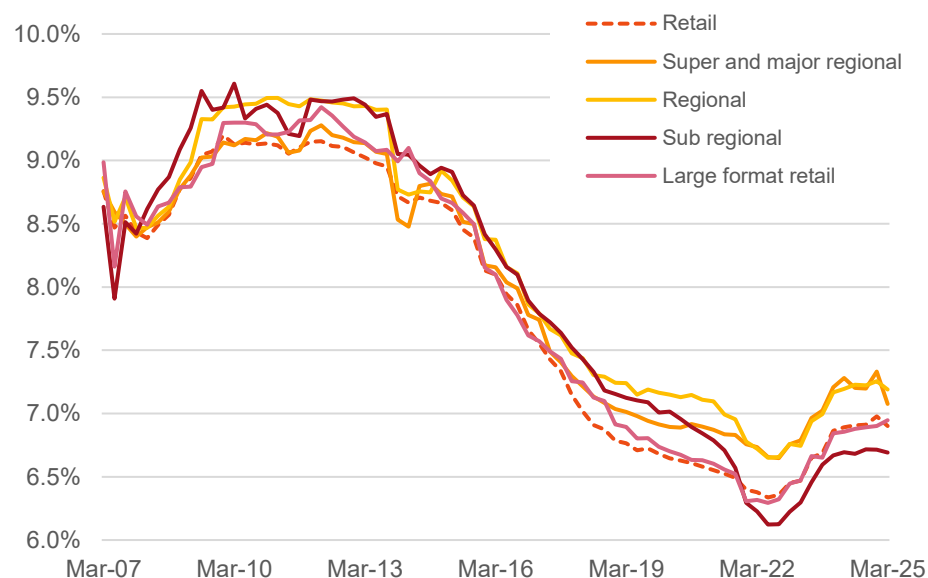
- Post-COVID-19, retail cap rates were pushed up by elevated inflation and interest rates. Since then, cap rates have mostly stabilised across all retail sub-sectors. Discount rates, which reached record-lows during 2022, are similarly flattening after a period of escalation.
- According to data provided by MSCI, capital growth within retail specialist funds remained negative for the year to 31 March 2025 (-0.2%). Total returns were 5.7% income returns offset negative capital growth.
- The performance of the retail property sector has compared favourably against the office sector, which has experienced significant capital losses over the past year (-8.9%), resulting in a total return of -4.1%.

Chart 8: Retail cap rates by sub-sector (%)



Source: MSCI, Frontier Advisors

Chart 9: Retail discount rates by sub-sector (%)



Source: MSCI, Frontier Advisors

Looking ahead

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														
The strongest demand driver for retail space is population growth. - Based on experts and research, we believe the required retail space per capita is circa double current levels. - For example, for supermarkets, ~0.3 square metres per person is considered the benchmark¹. - Population growth forecasts suggest future retail space demand will significantly exceed current stock.	A growing number of multi-channel retailers have expanded ‘click & collect’ sales, driving the need to maintain or increase shopping centre space. JB Hi-Fi satisfies half of all online sales through in-store click & collect. Share of online sales for click & collect <table><tr><th>Retailer</th><th>Share of online sales for click & 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%	Understanding of economic growth and forecasts should be granular for retail. - Which industries within an economy drive retail demand? - Quantum of this demand and changing nature of demographics offers insight into which retail categories will succeed.	According to the 2023 Intergenerational Report, median household incomes are forecast to rise circa 38% over the ten-year period to 2033. - Millennials and Gen Z are less likely to have mortgages than prior generations, increasing their net disposable incomes. - Rising interest rates and inflation impact disposable income and can reduce consumer consumption.	Investor demand is affected by the yield premium to long-term bonds. The retail sector has gone through a period of expanding yields. - We are likely entering a lower interest rate period, elevating the yield premium to long-term bonds. - Investor and occupier risk tolerance impact investment appetite.	Consumer sentiment is directly correlated to consumption levels. - Consumer sentiment has been at or near historic lows, but according to NAB and Westpac data, there are signs of improvement. - Growing pessimism around economic and employment growth, interest rates, and geopolitical conditions could impact the forward view and dampen consumer spending.
Retailer	Share of online sales for click & collect																		
Bunnings	85%																		
BCF	60%																		
JB Hi-Fi	50%																		
Woolworths	40%																		
Rebel	32%																		
Macpac	17%																		

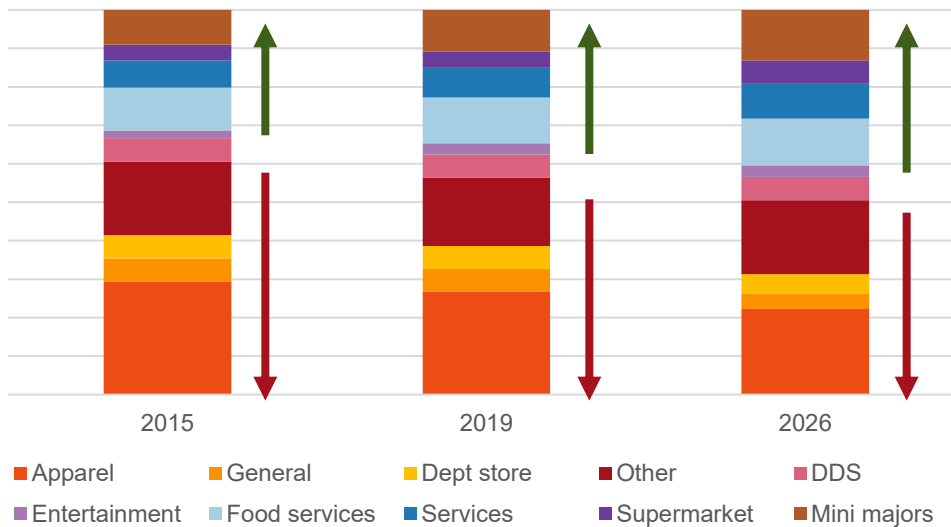
Source: ¹ <https://bit.ly/4idjrRw>, Company reports, MST Marquee

Demand spotlight: Tenancy mix and rent growth

A more resilient tenancy mix to online disruption can help maximise forecast rental growth

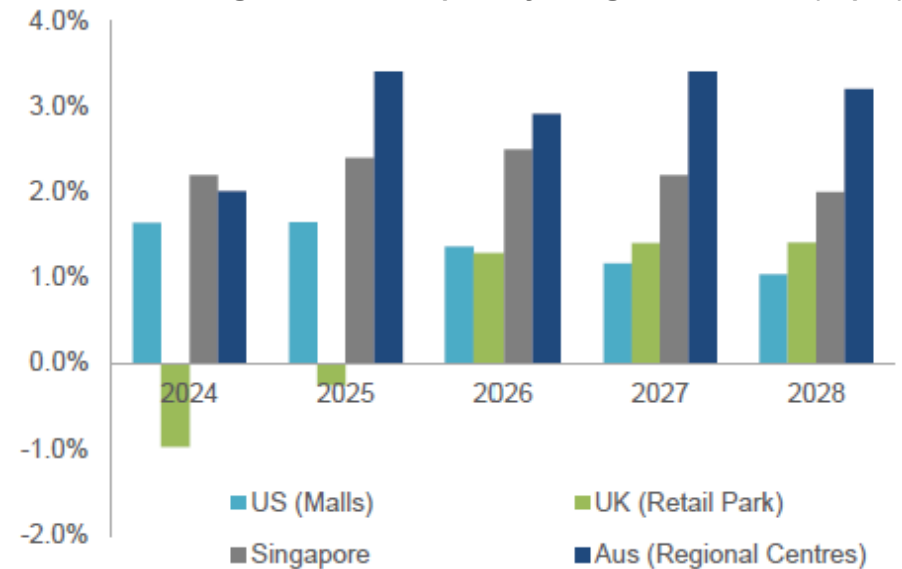
- Over the past decade, online retailing has been a significant disruptor for the retail sector. After a period of restructuring and repositioning, disruption to retail trade categories is likely to be less pronounced. For example, *department stores have cut their footprint at most centres and have a three-year notice period to landlords, where there is further scale-back, providing managers of centres ample time to fill the space with higher-returning uses.*
- Greater exposure to the growth categories highlighted in Chart 10 will drive money spent within centres and is thus expected to drive rental growth for landlords. Growth categories highlighted are also more resilient to online impacts.
 - Contracting sectors including apparel, department stores and general are forecast to shrink from 39% in 2019 to 31% in 2026.
 - Growth sectors including supermarkets, mini majors, services and food services are forecast to grow from 35% in 2019 to 40% in 2026.
- Specialty rental growth forecasts for Australian regional centres are generally higher than global peers over the next five years.

Chart 10: Regional centre income distribution by trade category (%)



Source: Lendlease, Urbis; DDS = Discount department stores

Chart 11: Regional centres' specialty rent growth forecast (% p.a.)



Source: JLL, CoStar, Moody's Analytics, Lendlease

Key indicators for Australian retail sector recovery

Highest barriers to entry across all other sectors constrains future supply

Supply drivers

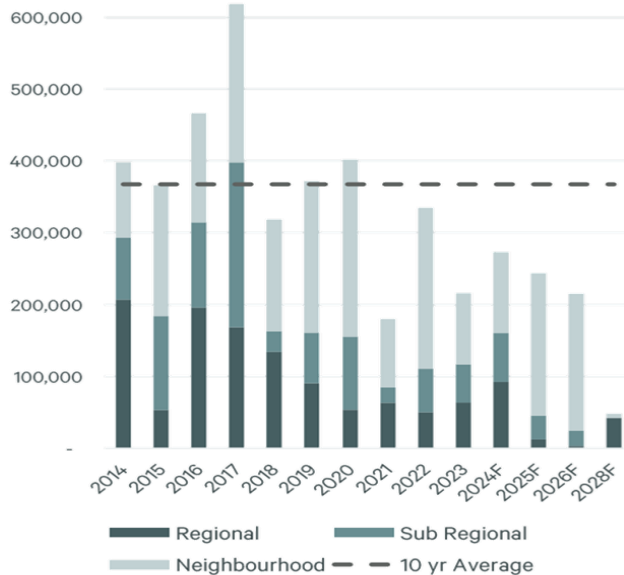
Vacancy rates	Future supply	Transport amenity	Development constraints	Demographic drivers	Highest and best use
Australian shopping centres, except during COVID-19, have maintained higher occupancy rates than global peers due to steady demand and limited supply. - Supply over the past decade has been well below historic averages. - Retail vacancy rates remain slightly below the long-term average of 2% in Australia.	Retail supply is expected to remain low due to high barriers to entry, lengthy development timelines, and sustained high construction costs. - CBRE predicts 75% of new retail projects in the next three years will focus on large format and neighbourhood centres. - Development in regional, sub-regional, and CBD centres will primarily see extensions and refurbishments, with no new construction forecasted for the next three to five years.	Successful retail precincts are reliant on being in close proximity to major arterial roads and public transport for easy consumer access. Tracking plans for transport projects allow us to look at where retail supply is more likely to be developed.	Rising land values, high construction costs and strict local council planning regulations have made retail development financially unviable. - Construction costs are expected to stabilise rather than decrease, requiring market rents to rise by 30-40% to support new developments. <i>JLL and CBRE forecast a 30% to 40% increase in rents to justify new development.</i>	Precincts with strong demographics are expected to perform well long-term. - Population growth and household formation. Net migration is a positive driver; however, migration intakes are moderating globally. If Australia was also to go down this path population growth may slow. - Number of dependents. - Median net disposable household incomes.	Retail centres often have underutilised land, such as vacant lots or carparks, offering opportunities for multi-use developments like healthcare or residential projects. Intrinsic development value must be unlocked in retail centres. Some retail managers are already advancing plans for healthcare facilities, often through partnerships with states or public-private partnerships (PPPs). The demand for housing and healthcare remains urgent.

Supply spotlight: Future supply

A mix of low future supply and unfeasible economic rent equations likely to benefit retail

- The construction industry has experienced significant cost push inflation over the past five years pushing up construction costs to record high levels. As a result, economic rents in commercial real estate have increased significantly above market rents. This thematic is more pronounced in the retail sector.
 - For construction projects to become feasible, construction costs must decrease (which is unlikely) or market rent must increase, bringing markets to equilibrium (more likely and reported to be between 30% to 40%).
- Australian retail development activity has been notably lower than in other countries, leading to one of the lowest shopping centre gross lettable areas (GLAs) per capita, globally. A period of lower-than-average development activity and low forecast supply for regional and sub-regional centres will also add pressure.
 - Development activity is a natural requirement for assets to avoid obsolescence. The side effect of this is that assets start to age and start to become less resilient, making asset and portfolio selection even more pertinent for investors.

Chart 12: Australian retail supply – historical versus forecast
(% of total stock)



Source: CBRE Research

Chart 13: Change in shopping centre supply per capita
(sqm per person, % p.a. to 2026)

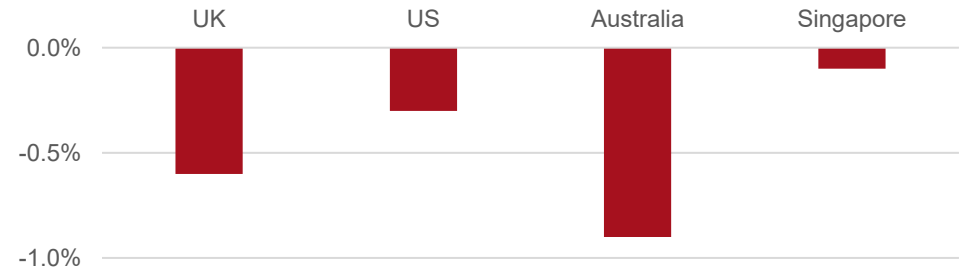
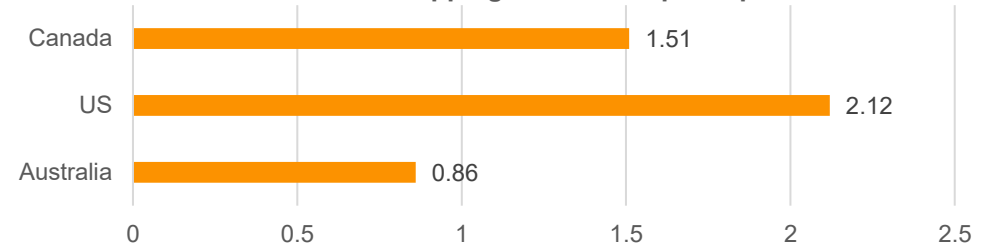


Chart 14: Shopping centre GLA per capita



Source: CBRE Research, Colliers Research

Critical economic pillars underpinning the retail sector

Stronger GDP growth, robust population migration, a re-valuation lag

Chart 15: Global forecasts – employment and economic growth

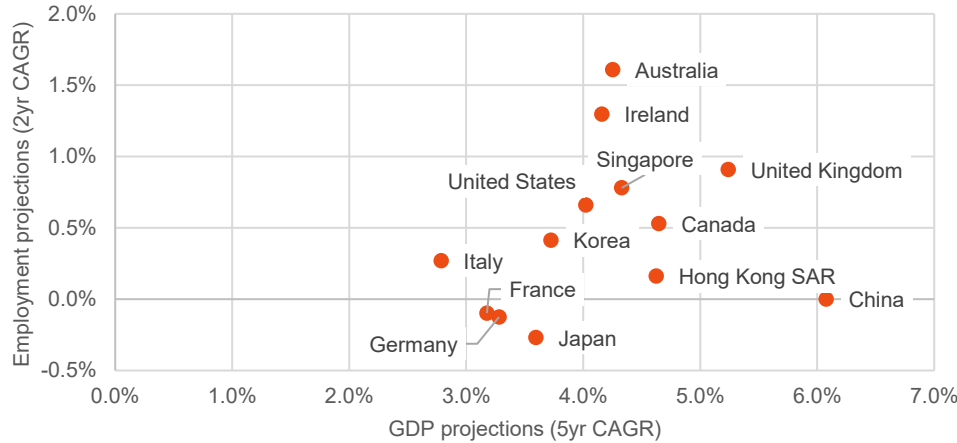


Chart 16: Global population forecasts (five-year CAGRs to 2030)

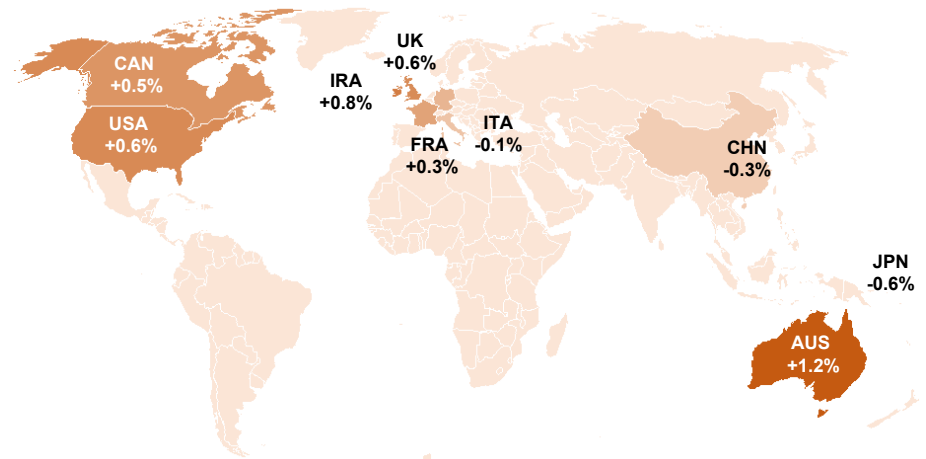
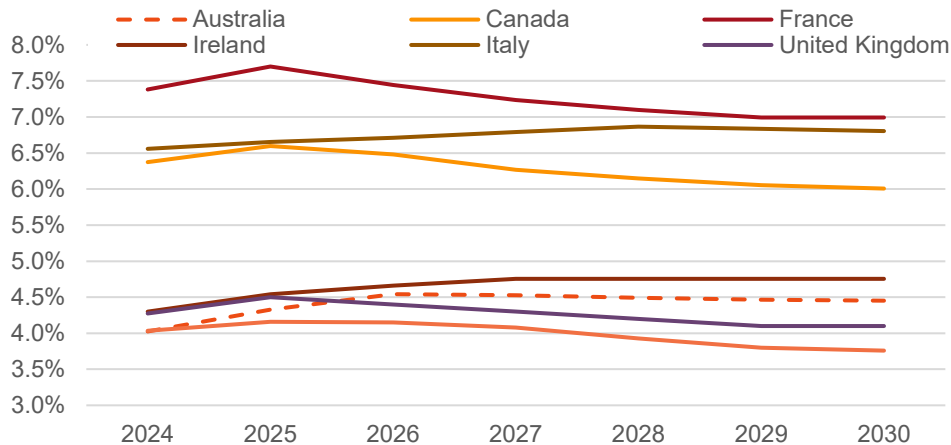


Chart 17: Forecast unemployment (by select countries)



Source: IMF World Economic Outlook 2025



Australia's economic outlook

- Australia's employment and GDP growth is forecast to outperform most developed economies, according to the IMF.
- Australia's population growth is forecast at 1.2%, the highest of any mature economy.
- Australia's job market is expected to remain tight at 4.5% in 2030, within the range generally considered 'full employment'.
- If high population growth remains, household discretionary income benefits the sector in the medium- to long-term.

Future technological advancements in the retail sector

Case study: Sales fulfilment by drones

Current service model

- In 2024 JLL reported Australian retail operators were experimenting drone technology in partnership with Google Wing. This delivery platform, owned by Alphabet (Google's parent company), is reportedly improving the way consumers shop for everyday goods such as food, groceries, and medicine.
- The model offers a competitive advantage for certain types of delivery, given its size and capability. For example, in comparison to deliveries being made by cars, where drivers must find parking and face traffic, drone delivery offers greater efficiency as drones can depart from a centre and travel directly to the destination. Safety is central to drone delivery success and long-term operations. The drone models operated by Google Wing have been built to Civil Aviation Safety Authority (CASA) standards which are similar to existing standards on commercial aircraft.
- Despite the potential upside for landlords, retailers and consumers, there are still some obstacles to the general use of drone delivery. Some challenges include the inability of drones to fly during decreased visibility and the relatively low maximum weight of goods carried in one load (circa 2.5 pounds or 1.12 kg)².

Where?

- Some landlords are experimenting with drone delivery, including Brookfield in the US and Vicinity and QIC in Australia, notably from Eastland Shopping Centre, servicing 26 suburbs in Maroondah, Victoria. These companies have partnered with Google Wing to deliver products from retailers in select shopping centres to consumers within a few kilometres. In South-East Queensland, the drone delivery service has been rolled out in Ipswich and in Logan in the Brisbane to Gold Coast corridor. Major participating centres include QIC's Logan Hyperdome and Mirvac's Orion Springfield.



Sales currently generated via drone delivery models are attributed to the shopping centres' tenants (in-store sales). Should fulfilment move to alternative locations such as industrial/logistics hubs, there may be a longer-term impact on retail sales. Much will depend on the advancement of drone technology and Vertical Take-off and Landing eVTOL models capable of flying further with larger payloads.

Frontier believes the impact of drones on retail income is likely to be low over the short to medium term. It is too early to predict an outcome within our current forecast period of ten years, but we continue to monitor developments.

Source:¹<https://www.jll.com.au/en/trends-and-insights/research/retail-centres-are-embracing-drone-delivery-in-australia>; ² QIC, Drone deliveries in our cities, 2024

Case study: Sales fulfilment by drones

Shopping centres currently participating in drone service

Drones at QIC's Eastland Shopping Centre, Ringwood, Victoria



Source: QIC; [How Wing's Drone Delivery Technology Works](#)

Policy on drones

- The Australian and Queensland governments and the City of Logan (City Futures Strategy) have been collaborating for a few years and engaging with broader communities.
- The City of Logan in conjunction with AlphaBeta has conducted surveys to assess the benefits to consumers, retailers and local businesses.

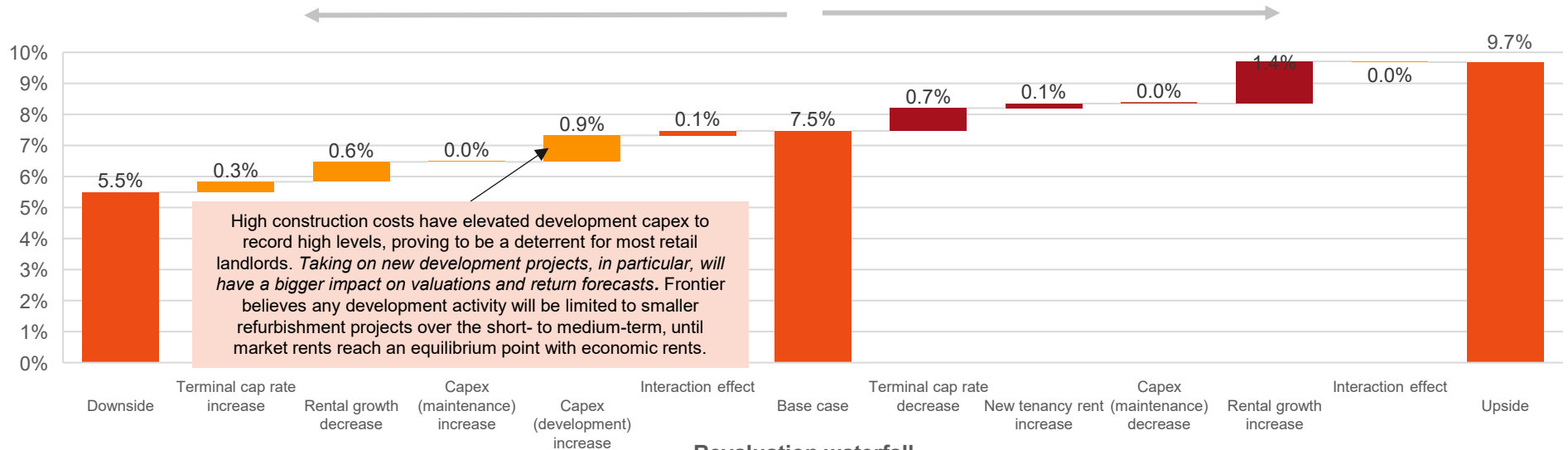
Global advancement

- Low Altitude Economy (LAE) includes manned and unmanned vehicles restricted to 1000 feet. It could include eVOTL aircraft.

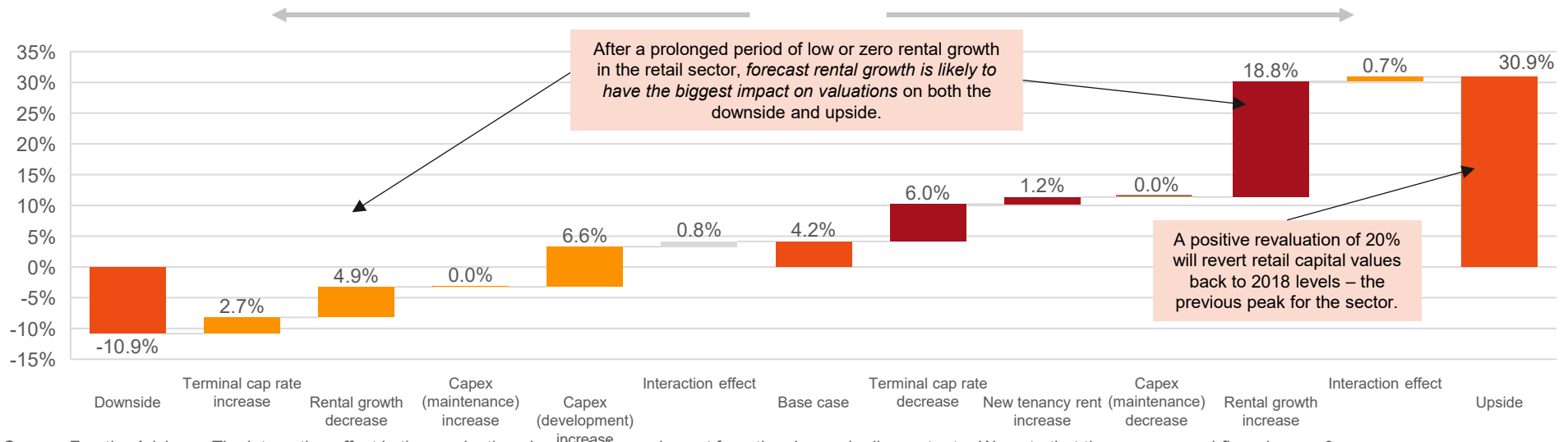
Key analysis

Discounted cash flow (DCF) analysis: Ten-year horizon

IRR waterfall



Revaluation waterfall



Source: Frontier Advisors. The interaction effect in the revaluation chart includes an impact from the change in discount rate. We note that there are no cashflows in year 0

Complexities of IRR and discount rates

Base case IRR of 7.5% v discount rate of 6.9%

Frontier's model base case: IRR: 7.5%

- Measures the profitability or expected return of an investment. *Rule of thumb: Accept the project if IRR > discount rate.*
 - Incorporates contractual rental growth.
 - Importantly, positive leasing spreads by quality of assets are outperforming valuer assumptions.
 - Retail categories (driven by lack of new supply).
- The model does not incorporate gains from unlocking landbanks/capex. However, certain types of investors may factor in their own assessment based on their risk appetite versus the risk-free rate. Buyers value development upside even though it may not immediately be apparent in a typical valuation model – although it will be apparent in the number of bids.

Frontier's discount rate: 6.9%

- Primarily an input – the rate used to discount cash flows to their present value or the required rate of return.
- Informed by independent valuer assumptions which are provided to instructing funds or clients.
 - IRR should be above the discount rate because it signals for a 'good' investment with potential upside. If it is equal, it is not a profitable investment.
 - The discount rate will be different among investors types, depending on their risk-free rate and their own assumptions.
- Discount rates reported by MSCI as the weighed average for the retail sector is 6.7-7.2% (sub-regional to regional) as at Q1 2025.

Source: Frontier, JLL, CBRE

Scenario analysis – DCF valuation and IRR impacts

Recent retail transactions are largely in line with Frontier's base case

Based on Frontier's DCF analysis, over the next ten years retail portfolios are expected to be revalued between +30.9% (upside) to -10.9% (downside), corresponding to IRRs of 9.7% (upside) to 4.2% (downside). At a base case, an expected ten-year IRR of 7.5% is a relatively attractive risk-adjusted return compared to current bond yields and within Frontier's capital markets equilibrium assumptions of 8.0% for core Australian property.

Portfolio scenario analysis – Ten years

Scenario analysis – net present value	Downside	Base	Upside
Revaluation impact (%)	-10.9%	+4.2%	+30.9%
IRR (%)	5.5%	7.5%	9.7%

In the table below, we use the *base case* to test the sensitivity to the expected portfolio IRR to both the terminal capitalisation rate and the initial cap rate. Based on this analysis, the IRR ranges from 4.9% to 10.4%. The downside and upside metrics are not reflected in the matrix owing to different underlying assumptions.

Base case: IRR sensitivity analysis – Ten years

		Current cap rate (%)					
		5.0%	5.2%	5.6%	6.0%	6.2%	6.4%
Terminal cap rate (%)	6.7%	4.9	5.4	6.4	7.3	7.7	8.2
	6.5%	5.1	5.6	6.6	7.5	8.0	8.4
	6.3%	5.4	5.9	6.9	7.8	8.2	8.6
	5.9%	5.9	6.4	7.5	8.3	8.8	9.2
	5.5%	6.5	7.0	8.0	8.9	9.3	9.8
	5.3%	6.8	7.3	8.3	9.2	9.6	10.1
	5.1%	7.1	7.6	8.6	9.5	10.0	10.4



Frontier's analysis does not reflect any major redevelopment of uses (e.g. re-zoning and introduction of mixed-use, including office, hotel or healthcare). While we believe current market prices (i.e. 19% decrease in price from the peak in December 2018) are appropriate for a generic retail portfolio, asset quality diversification is key to resilient portfolios. Frontier's recommendations are subject to asset specific considerations.

Source: Frontier Advisors. Note analysis for the 'base case' is based on discount rate of 6.9%; a higher (lower) discount rate may lead to larger (smaller) devaluations.

Why retail, why now?

Opportunistically allocate to selective prime retail supported by strong demographics



Frontier's model portfolio proposes a slight change of the long-term allocation between 15% to 35% (compared to the previous range of 20% to 40%). This adjustment acknowledges the changing composition of domestic and global benchmarks.

Why prime retail assets? Catchments with strong underlying demographic drivers (e.g. high net disposable income, low competition, good transport amenity), well positioned for climate change and with low carbon emissions and social commitments should outperform sub-optimal assets.

Assets should clearly demonstrate *regulatory* and *economic resilience*. This requires clear repositioning paths and associated capital expenditure.

For the retail sector, low levels of forecast supply will likely be the biggest contributor to rental growth and thus positive revaluation.

Disruption to retail trade categories is likely to be less pronounced than over the past seven years as the sector has largely restructured and repositioned itself post COVID-19. Retailers have found a way to capture both online and instore sales.

The impact of online retailing is lower than other countries owing to the geographic diversity of Australia. The rise of multi-channel retailing and growing demand for 'click & collect' services at major shopping centres now appears entrenched in the way Australians shop. Nevertheless, growth in online sales should be expected as well as disruption over the longer term by drones and other forms of non-human delivery such as AEVs and eVTOLs. Frontier will continue to monitor tenancy trends.

Frontier prefers retail assets with surplus land (land banks) which can be repositioned for expansions, mixed-use and/or alternate uses (e.g. healthcare assets). However, the value proposition of this is not yet clearly discernible at this stage. Managers are beginning to assess potential value accretion which is contingent on timely planning approvals, policy support and high construction costs impeding financial feasibilities.

The modelled ten-year IRR is circa 7.5% (for the base case), which is in line with Frontier's capital markets' equilibrium returns for Australian core property (8.0%). The modelled ten-year IRR is slightly more favourable than Frontier's ten-year returns (circa 6.2%) and 20-year returns (circa 7.1%) for Australian core property.

- Positive economic outlook (including jobs growth, rising wealth and income) could provide upside, as would further cap rate compression.
- Capital expenditure (both development and maintenance) could lead to a short-term deterioration in return expectations with development capex likely to be the biggest detractor to returns and growth in the sector.

Implications for portfolios

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.

Actions for clients

Start with a review of your portfolio

Depending on liquidity needs, rebalancing options vary:



Clients requiring liquidity should:

- Form a course of action in advance.
- Consider secondary trades in advance of windows if liquidity needs are high.



Clients not requiring liquidity and underweight property allocations (particularly retail) should:

- In certain funds facing liquidity issues, lodge redemption requests if it is likely residual portfolios will be sub-optimal due to asset sales.
- Seek exposure to funds that can generate resilient income with a strong skew to non-discretionary retail.
 - Consider other alternative sectors in catchments with strong local demand.
 - Consider opportunities focused on disruptions.



Clients who are underweight real estate allocations within a wider portfolio:

- Seek diversification across secular themes with growing demand and strong supportive structural drivers.
- Invest at points in a cycle with more favourable fundamentals. For example, through secondaries at favourable points in the cycle.
- Allocate to needs-based sectors such as residential, logistics, grocery-anchored retail, technology driven solutions (data centres and proptech) via equity and debt.



Clients who are unable to invest in unlisted funds, GREITS and real estate debt can provide attractive opportunities.



Clients typically have a high home-country bias to property with a high allocation to the retail sector.

Frontier continues to recommend increased diversification to needs-based sectors such as housing, healthcare, life sciences and logistics, which are underpinned by enduring demographic fundamentals and less sensitive to economic cycles.

An allocation to GREITs can achieve exposure to these sectors, help achieve reasonable scale and improve diversification.

Speak to your client team or a member of our Real Assets Team about potential options and solutions.



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