Market Insights
Retail Outlook
2017

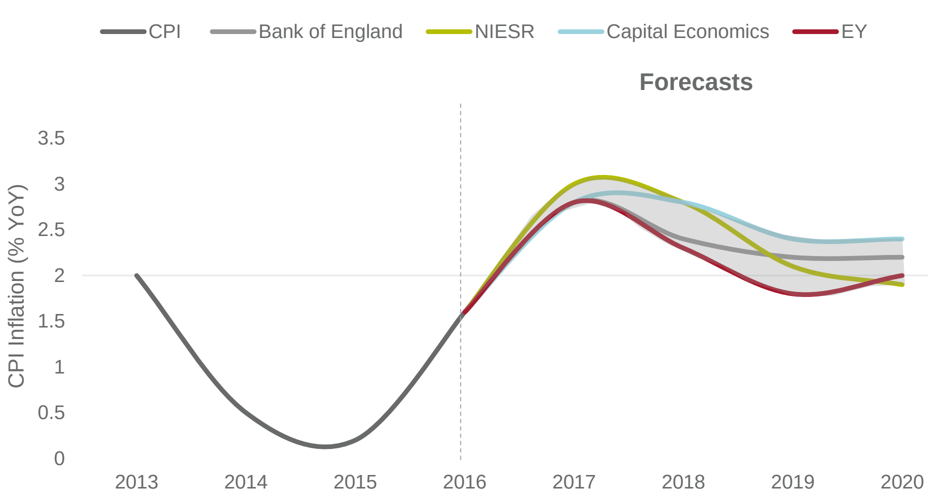
The outlook for the retail sector will be mixed. Economic and political events are expected to weaken consumer confidence and retail spend, while technological advances will continue to change the dynamics of the sector.

Rising inflation to impact future consumer confidence and spend

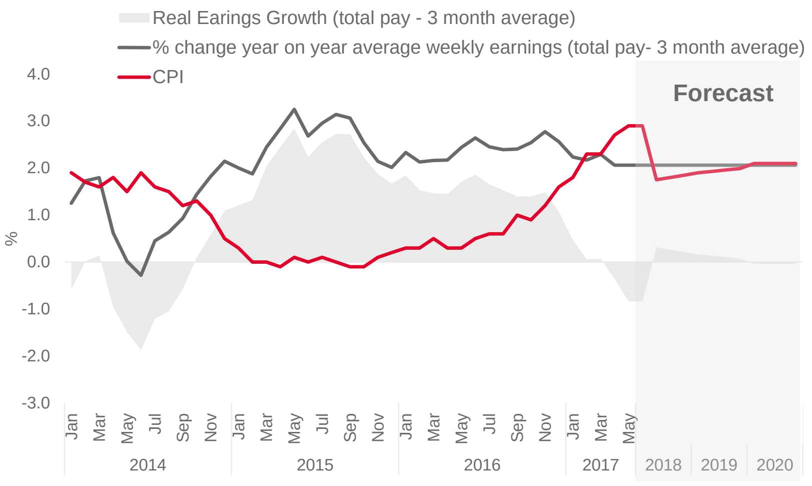
The consumer has been the driving force of the UK economy over the past decade, with the contributions from household spend making up a consistently high and positive component of GDP growth. However, as we progress into 2017 we are likely to see the pace of consumer-led growth slow as rising inflation erodes real incomes. Sterling's post referendum fall has started to feed through to headline inflation, with CPI surpassing the Bank of England's 2.0% target , reaching 2.9% in May. Inflation forecasts for 2017 vary across economists, with the majority forecasting CPI to hover around 3.0% by year end.

Critical to consumer confidence and the level of household spend is the strength in labour market conditions and job security. To date, employment conditions remain tight, however a variety of measures are pointing to slower employment growth prospects ahead.

CPI Inflation Forecasts, **Source: ONS, HM Treasury, EY, CE**



CPI Inflation & Real Earnings Growth Source: ONS, HM Treasury Consensus



Retailer cost pressures are building

Retailers will have to contend with a number of cost pressures in 2017. The business rates revaluation (which came into effect on 1st April 2017) will raise occupational costs for many retailers. The revaluation will be based on property rental values at April 2015, thus those locations that have seen the greatest increases in ERV growth between this point and the previous rates revaluation (April 2008) will be hit hardest. The gentrification of Brixton in South East London has led to a considerable uplift in retail ERV's since 2008, as a result, occupiers are expected to see their rates rise by 120% after the transitional phasing ends, while West End retailers could be hit with a c.80% increase in rateable values. These increases are expected to impact small, independent retailers and businesses run on tight margins. For retailers outside of London, the rates revaluation will be less burdensome given the smaller (or in many cases declines) in rental growth seen since the last rates revaluation.

Labour costs are also on their way up. The National Living Wage (initially introduced in April 2016) is expected to rise over the coming year as the government proceeds to meet its target in reaching the median wage by 2020. This, along with the Apprenticeship Levy and the National Minimum Wage, will increase labour costs across the retail industry. Currently staff costs make up 45% of total operating costs, therefore future wage increases will be a bigger burden for retailers than business rates. Over the medium term this could spur retailers to reassess their store networks, and potentially increase their use of technology relative to labour to make efficiency gains and reduce labour costs.

Technology will continue to improve the consumer retail experience

Technological advances will continue to change the retail experience in 2017, with new digital methods such as virtual retailing, payment methods such as facial recognition and finger print payments among some of the new innovations that are likely to be trialled during 2017. Luxury retailers are also expected to become more engaged with social media in order to expand their brand to overseas consumers and millennials who frequently use technology in their daily shopping routines. While traditional retailers will continue to adopt new technologies, pure play operators (online only retailers), will look to grow their in-store presence in 2017.

New supply could have the potential to reshape existing retail pitches

This year will see the largest spike in new retail space since 2013. More than 2.7 million sq ft of retail floorspace will enter the market in 2017. The new supply will be concentrated in six new large scale shopping centre schemes, including the Victoria Gate, Leeds and Bond Street, Chelmsford (both anchored by John Lewis) and the Lexicon in Bracknell. In addition, eight existing shopping centres will undergo refurbishments including the extension of Westfield Shopping Centre in Shepherd's Bush, London and the redevelopment of the Westgate Shopping Centre in Oxford. New shopping centre developments can significantly change the retail landscape, re-configuring the prime pitch around the new scheme and diverting consumers away from traditional thoroughfares.

DTZ Investors' Sector View

The retail economy will face a number of headwinds in the short term, but with the outlook for offices under pressure from political events and high demand for industrials from various market players, retail should provide more attractively priced, income driven opportunities for investors. The table below gives a brief assessment of our current views for the retail sector, identifying the opportunities and challenges over the next 12-18 months.

	Sector Prospects	MSCI Income Yield	DTZ Investors' Recommendation
London High Street	• **Central London:** Despite acute cost pressures in Central London, demand for showroom space on the main high streets of London should remain resilient, resulting in positive rental growth for 2017. • **Greater London:** Rapid population growth, a series of regeneration projects and infrastructure improvements should set the path for new and vibrant retail destinations to be created around Greater London, offering high yielding returns in the short term to medium term and strong capital gains over the long term as areas become more established over time.	3.7% (Central London) 5.1% (Rest of London)	**Neutral** (Central London) **Positive** (Greater London)
Top 50 High Streets (exc. London)	• Destination retail offering a mix of retail, leisure and beverage use should remain resilient to the expansion of e-commerce. Retail rents across most centres remain affordable and downward adjustments to business rates in regional markets should improve the levels of occupier demand in the short term. • Markets supported by tourism, where the catchment spend is above the UK average, and the population consists a mix of age groups should deliver better performance prospects.	5.7%	**Positive** but need to be selective
All Other Regional High Streets	• Retailers are likely to remain cautious on their choice of location region wide, preferring dominant town centre locations over small / medium sized towns that are less dominant in their catchment. As a result, performance prospects are expected to be weaker than the top 50 high street locations. • The variation in current availability across the sector means investors should be very selective when targeting this segment, focussing on those locations that are underpinned by an affluent population.	6.3%	**Negative**

**Equivalent Yield as at December 2016*

	Sector Prospects	MSCI Income Yield	DTZ Investors' Recommendation
Retail Warehouses	• Lower occupational costs, the availability of larger sized units and other convenience factors are compelling attributes that could persuade high street retail occupiers to take up space on well located out-of-town parks. While expanding brands and new bulky good entrants should improve the outlook for better quality bulky good parks.	6.2%	**Positive**
Supermarkets	• Supermarket chains are planning to expand in 2017, particularly bargain brands. Large scale investment by the big four supermarkets to improve their brand, range and customer offering should assist these market players over the medium term. Overall, the sector should offer safe, market average income return prospects for investors over the short term.	5.0%	**Neutral**
Leisure	• Increased tourist numbers off the back of Sterling's weakness and the resurgence in households 'staycating' rather than vacating as the costs of holidaying abroad shoots up, should support leisure spend in the near term. • Short term risks to the sector include higher inflation which could lower the levels of discretionary spend that is channelled to the leisure sector.	6.0%	**Positive**
Restaurants	• Market evidence appears to suggest that the sector is still in expansion phase, with continued growth in healthy eating and vegetarian restaurant concepts and advances in the food-to-go sector. • Increased operational costs against slowing like-for-like sales growth could cause some casualties over the medium term, therefore locations on affordable rents and a high percentage of the catchment is supported by a working population should be more resilient.	4.6%	**Neutral**

**Equivalent Yield as at December 2016*

AUTHORS

For more information on this topic please contact:

Andrea White
Investment Strategy
Associate Director
Tel: +44 (0) 20 3349 0228
Email: andrea.white@dtzinvestors.com

Fiona Chan
Investment Strategy
Investment Analyst
Tel: +44 (0) 20 3349 0266
Email: fiona.chan@dtzinvestors.com

About DTZ Investors

DTZ Investors is a full service, vertically integrated, real estate investment and asset manager. Features of our core service include investment strategy advice, deal sourcing and underwriting, financial structuring, ongoing asset management and property management, regular portfolio review to assess risk, and client reporting. DTZ Investment Management is authorised and regulated by the Financial Conduct Authority. Registered in England no. 4633215. Registered Office: 125 Old Broad Street, London EC2N 1AR.

Important Notice

DTZ Investors
Capital House
85 King William Street, London,
EC4N 7BL
Tel: +44 (0) 20 3349 0349
www.dtzinvestors.com