Dublin Retail Market in Minutes

Q4 2015

Hugo Boss - 67 Grafton St.

Liffey Valley Shopping Centre - Aeropostale

Joules - 12 Wicklow Street

Economic Overview

Ireland's economy has continued on the front foot since our last report with real GDP growing at an annualised 6.7% in Q2. Favourable tailwinds, including a weak Euro and solid external demand, have contributed to a fifth successive quarter of double-digit exports growth. However, the domestic economy is also responding to a continued improvement in the jobs market, low oil prices and rock-bottom interest rates. Unemployment dipped below 9% in October for the first time in nearly seven years and earnings growth is up to 2.7% per annum. This has propelled domestic demand growth into double digits and the internal economy is now expanding at its fastest rate for almost 10 years.

Retail Economy

With the economy performing extraordinarily well, and with October's expansionary budget now built into consumer expectations, every window into the retail economy is showing a positive picture.

Retail sales are up 6.9% in real terms over the last 12 months and Figure 1 shows the breadth of this improvement. Every dot on the graph is either on or above the horizontal axis, indicating that no sector is experiencing a contraction in sales. This has led to a broadly-based increase in the demand for retail space with both international and indigenous operators from across a wide range of sectors taking space since the start of 2015.

The economic improvement has led to a sharp slowdown in the number of business failures and rental abatements. Nonetheless the closure of two of Dublin's great retailing institutions - Clerys (June 2015) and Boyers (early 2016) – serves as a reminder that trading conditions remain challenging for some operators. Further evidence of this is seen in Figure 1. While all of the dots show sales growth, most are positioned to the left of the vertical axis, indicating that prices are falling. This does not imply that retailers' viability is being squeezed – lower commodity prices, reduced overheads and efficiency gains have made it possible for shopkeepers to cut prices at the till. But the fact that they have had to pass these gains on to the consumer confirms just how competitive the retail sector remains.

Bars are the only retail category where both volume sales and prices are rising. However, discounting is beginning to ease in many other sectors, perhaps suggesting a gradual return of pricing power to retailers as the economy strengthens. Figure 2 shows that the biggest shift has been in electrical goods stores. Two years ago prices were falling by 6.5% year-on-year. Despite this, volume sales were also contracting at a rate of 2.6%. Today the picture is much healthier with sales volumes rising at almost 11% per annum and prices falling less steeply. Clothing stores have also been moving in the right direction. Sales were sluggish in 2013 but have picked up very strongly with volume growth of 13.5% in the year to October. At the same time discounting has eased back from 4.1% per annum to 3.4%. This dynamic has encouraged numerous fashion brands – including Aeropostale, Calvin Klein, Hugo Boss, Joules and Jigsaw to enter the Irish market or expand their presence in recent months.

In previous reports we commented that furniture stores have been enjoying a strong run with average volume sales growth of 18% over the last two years. As illustrated, the rate of growth has accelerated since 2013, while price cuts have become smaller. Unsurprisingly this has fed into an increased number of enquiries from international furniture operators seeking space in the Irish market.

Reflecting lower commodity prices and continued discounting, grocery stores are moving in the opposite direction. From a position two years ago where sales and prices were static, volume has picked up by almost 5% in the year to October. However, this has come at the expense of disinflation with prices falling by 1.6% in the last 12 months.

TABLE 1
Consumer Economy Dashboard

Indicator	% Change Y/Y
Savings Ratio	-23.9
Consumer Sentiment	18.4
Live Register	-10.6
Real VAT Receipts	7.9
Real Final Domestic Demand	7.7
Real Retail Sales	6.9
Real GDP	6.7
Real GNP	5.3
Full Time Employment	3.8
Real Average Gross Earnings	3.0
Total Employment	2.9
Real Personal Consumption Expenditure	2.8
Henry Street Footfall	1.6
O'Connell Street Footfall	1.5
Grafton Street Footfall	0.3

Sources: CSO, KBC Bank Ireland/ESRI, Dublin Town and Dept. of Finance.

FIGURE 1
Retail Sales Volume and Price Growth by Sector (3mma), October 2015

Sources: CSO, Savills Research

Retail Rents

According to data from MSCI the retail ERV index fell for 22 consecutive quarters between June 2009 and September 2014. However strong jobs growth has created a level of confidence that, on one hand, is encouraging consumers to spend more freely and, on the other hand, is allowing retailers to commit to lease contracts at higher rent levels. As a result rents on new lettings have been rising at an accelerating pace for the last four quarters. The overall MSCI retail ERV index is currently increasing by 4.1% per annum and, as illustrated in Figure 3, our forecasting model predicts a further 17.5% uplift over the 18 month period to March 2017. Taking into account the calculated margin of error, there is only a 2.5% likelihood that rental growth will be less than 13.4% cumulative over this period.

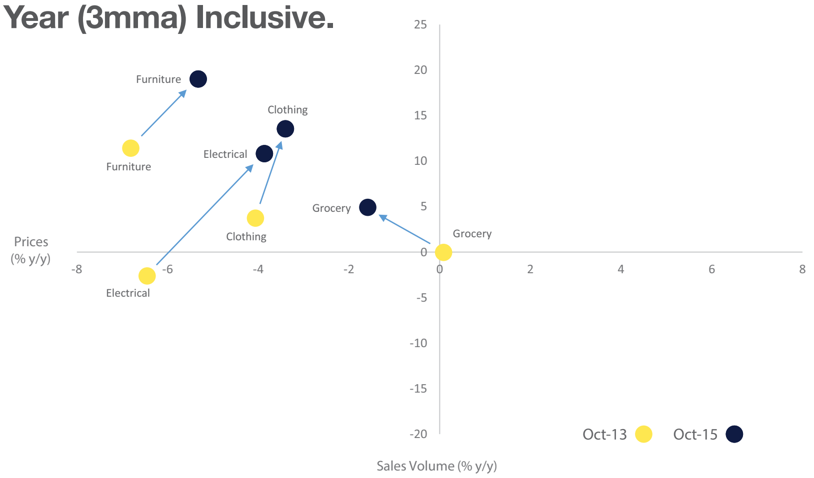
Rents on the main city centre high streets and suburban malls have been rising more quickly. Zone A rents currently stand at approximately €4,000 per sq m on Henry Street and have been moving up quickly. MSCI data indicate that ERVs on Grafton St. – Dublin's premier retail thoroughfare - rose by 13.3% in the 12 months to September – their fastest growth rate since early 2007. Zone A rents in this location are currently at around €5,500 per sq m and our forecasting model points to further cumulative increases of just over 30% in the Grafton St. sub-index by March 2017.

Retail Development

Low bond rates have seen a continued flow of money into Irish commercial property. With office values rising and with the consumer recovery gaining traction, an increasing share of this capital is finding its way into retail assets. As a result, yields on prime retail properties have compressed by 125 basis points over the last 12 months and now stand at around 3.5%. In tandem with rising rents this has driven up capital values, inevitably bringing retail development back onto the agenda. So far activity has mainly been confined to existing schemes where the space exists to expand what is already in place. Good examples of this are the recently opened extension at Kildare Village and the improvements at Liffey Valley Shopping Centre which include recent upgrades to the food court and cinema, and which will lead to six additional restaurants and a new Penneys store next year. While a number of similar projects are now in the planning or pre-construction process it could be some time before we see an all-new retail scheme in Ireland. In saying that, the demand for retail development sites has clearly increased, and further development is likely to emerge eventually.

FIGURE 2

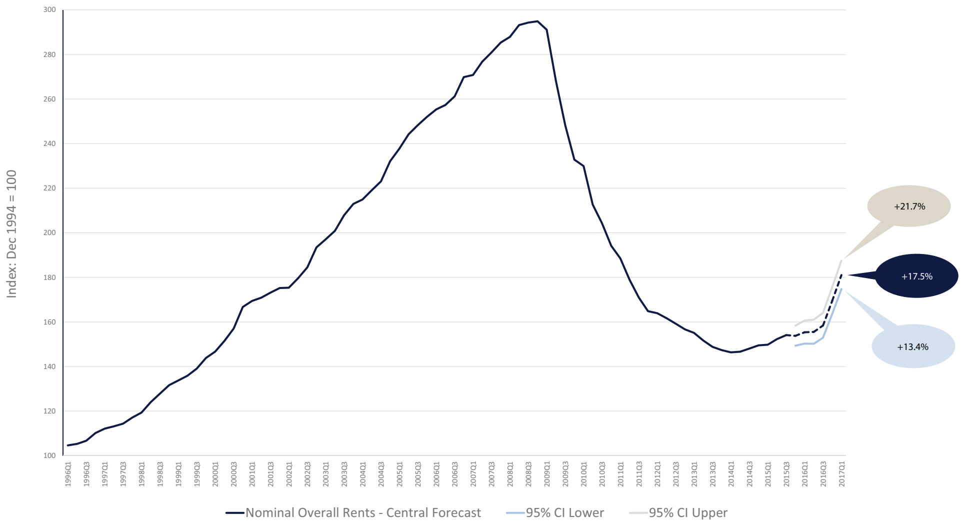
Retail Sales Volume and Price Growth by Selected Sector and Year (3mma) Inclusive.



Source: CSO, Savills Research

FIGURE 3

Overall Retail Rents Forecast Q4 2015 – Q1 2017 Inclusive.



Source: Savills Research

Liffey Valley Re-Development - Western End

OUTLOOK

GDP now looks certain to grow by more than 6% this year and, according to consensus forecasts, this momentum will continue with growth of around 4.4% pencilled in for 2016 and 3.5% for 2017. Earlier in the recovery there was a sense that the improving macro-economic numbers were not necessarily reflected in consumers' personal experiences. However sustained jobs growth has led to a sharp fall in the live register and employers are once again having to compete for talent. Consequently earnings growth is accelerating. Partly as a consequence of this, the public finances are now improving very dramatically, and this has led to a growing perception that fiscal austerity has finally ended. Ultimately the recovery is now being felt on the ground and this is feeding into a sense of confidence among both consumers and retailers which will continue to drive rents.

Online sales have undoubtedly benefited from the improvement in trading conditions and we expect this to continue. However, this is not necessarily a negative for retail property. Successful retailers are increasingly adopting a multichannel 'clicks-and-bricks' approach. This has led to a change in the way many are using their physical space – for example fashion stores are increasingly being configured as showrooms where people go to try different styles before buying online. The perception that e-commerce is driving retailers off the high street is gradually being replaced by a more nuanced understanding that the advantages of having a physical point-of-contact with the consumer are also attracting online brands into bricks and mortar. In time we expect that e-commerce will create a more diverse mix of brands in shopping locations. We also expect the recent upsurge of demand from restaurant and café operators to continue. This will lead to a higher food and beverage content within the overall retail mix as providers of personal services that cannot be delivered online benefit from the ongoing redefinition of shopping as a leisure activity in itself.

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