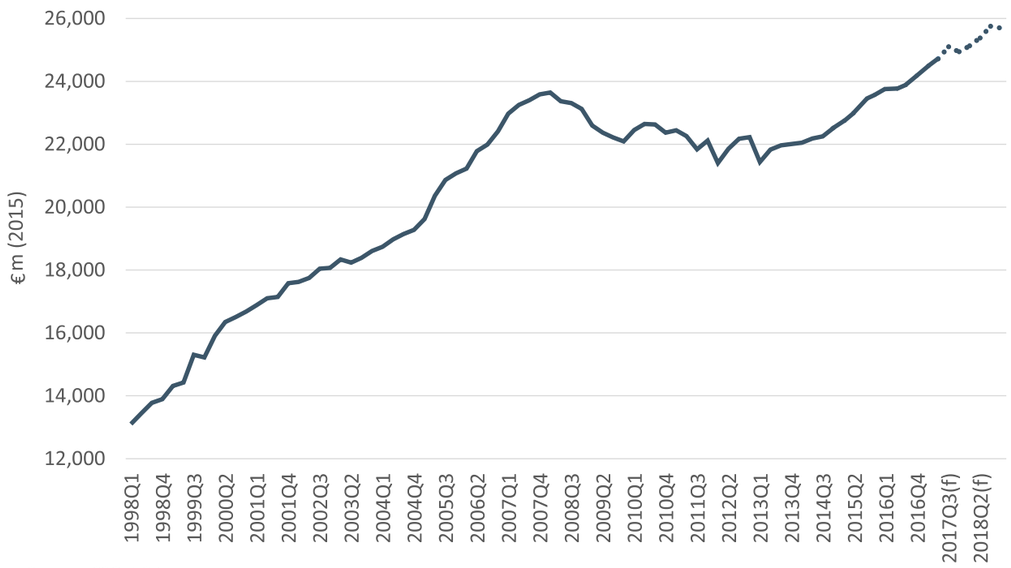
Retail Market in Minutes
August 2017

savills

Economic Overview

Last year's economic momentum has carried into the opening half of 2017. GDP growth has accelerated to 6.1% per annum – compared with 2.4% across the EU - and consumer expenditure is making a significant contribution to this. As shown in Figure 1 total spending on goods and services is now comfortably above previous peak levels. The ultimate source of this is jobs growth. Ireland is currently creating nearly 70,000 additional jobs per annum - the fastest rate of employment growth in almost a decade. As a result unemployment has fallen to 6.4%, leading to a more competitive labour market and a sustained period of modest but meaningful earnings growth. Rising employment has also taken pressure off the public finances, creating fiscal space for modest tax cuts in the last two budgets and raising the prospect of further concessions in October. All of this has fed into a 4.0% increase in real household disposable incomes over the last 12 months. Adding to this, sustained growth in consumer credit balances has further boosted consumers' spending power. Looking ahead, despite continued global uncertainty, the current strength of Ireland's economy has led forecasting institutions to raise their GDP growth projections. A simple average of these suggests growth rates of 4.1% and 3.5% in 2017 and 2018 respectively.

FIGURE 1:
Personal Expenditure on Consumer Goods and Services



Source: CSO, ESRI

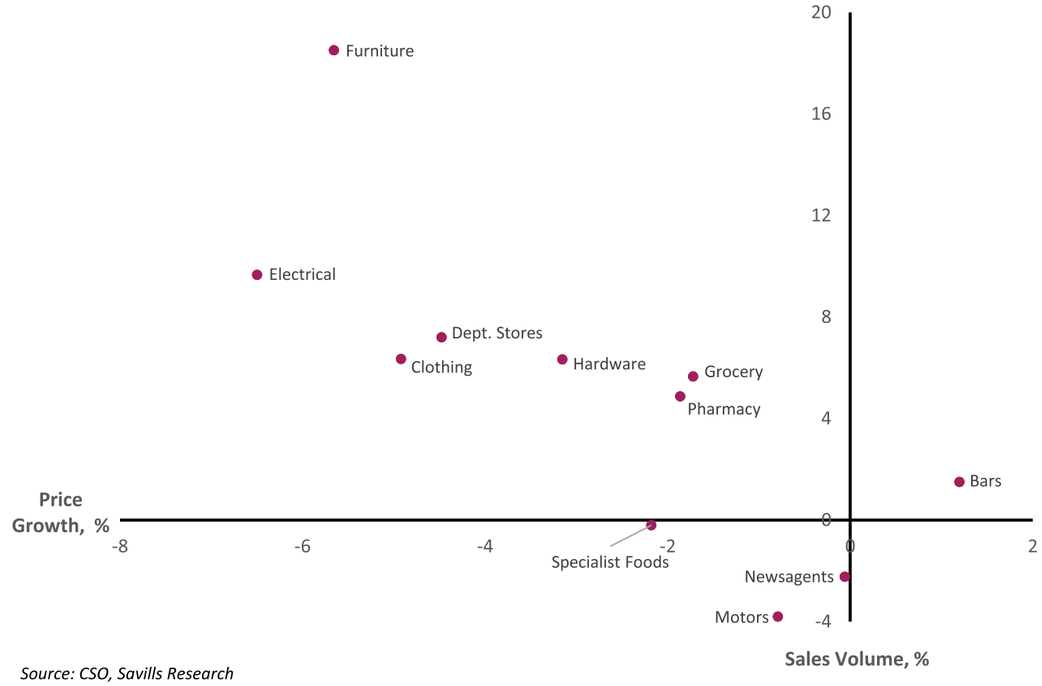
Retail Economy

Retail sales growth slowed to 3.0% in the first half of 2017. However, this slowdown was almost entirely due to a leakage of motor sales to the UK, with consumers taking advantage of the more favourable EUR/GBP exchange rate. Indeed used car imports have increased by 43% in the first half of the year. However, stripping out cars reveals a very different picture, with growth in core retail sales actually accelerating from 3.5% to 7.1% in the opening half of 2017.

While most sectors continue to enjoy sales growth (dots above the horizontal axis in Figure 2) – only licenced premises are positioned to the right of the vertical axis, indicating rising average prices.

In all other sectors prices are falling. Indeed deflation has been a consistent theme in Irish retail for nearly five years and, in 8/10 sectors where prices are falling, the extent of discounting has deepened over the last 24 months. As we have previously noted, one reason for this is an ongoing compositional shift in the Irish retail landscape towards mid-market and value brands. It also reflects lower input costs for retailers due to lower oil prices since mid-2013 and, more recently, weak Sterling. However, the fact that retailers are being compelled to pass-on these savings to the consumer illustrates just how competitive the retail market in Ireland is, and the continuing disparity between volume and value sales is an area of focus for retailers trading in Ireland.

FIGURE 2:
Annual Retail Sales & Price Growth by Sector (3-mth Mov. Avg. June 2017)



Source: CSO, Savills Research

Leaving aside the decline in new car sales, several other notable trends are evident in Figure 2. Furniture stores continue to enjoy the most rapid growth in volume sales. This reflects improved disposable incomes, a strong trend in household formations, sharply rising house prices and the introduction of the Government sponsored Home Renovation Incentive (HRI) – the latter of which have encouraged people to invest more in their homes.

Although mainstream grocery stores and specialist food shops (e.g. butchers, greengrocers, health food stores) continue to discount at similar rates, volume sales growth has differed markedly. Supermarket-type grocery stores are trading well with volume sales growth accelerating from 2.7% in June 2016 to 5.7% currently (on a 3 month moving average basis). However specialist food stores are experiencing a contraction in both sales volumes and average prices. This perhaps reflects increased competition from the multiples which have been improving their customer proposition and offering greater choice through the provision of in-house craft butchers, fishmongers, health food product lines etc.. These strategies mean that shoppers can increasingly find everything they need under one roof. While clothing stores continue to trade well, volume sales growth has more than halved over the last 12 months. Some of this can be explained by a base effect – sales in this sector are up 44% from the low point in April 2013, making it increasingly difficult to register dramatic percentage growth rates. But it possibly also reflects competition from online sales which are largely excluded from the official retail sales statistics.

CSO figures show that clothing is the most common online purchase by internet users in Ireland with 44% buying clothes though this channel in the year to March 2017. Unsurprisingly, this number is inversely correlated with age – 57% of 16-29 year olds bought clothing online compared with just 33% of 45-59 year olds and 14% of those in the 60-74 age group. Perhaps more surprising is the fact that, despite better broadband coverage in Dublin, internet users in the capital were not the most likely to buy clothing online – 46% of them did so, exactly the same proportion as in the South-West region and fewer than in the West (50%). One interpretation is that, where a good quality retail offering is available locally, consumers continue to use the face-to-face channel for fashion purchases.

The debate about how online shopping is impacting on traditional retail will develop as new business models continue to emerge and evolve. However, based on observations of Savills teams across the global business, some general themes are beginning to crystallise;

'Omni-Channel' Retailing – The most successful businesses are exploiting the natural synergies between online and physical retailing through an 'Omni-Channel' approach. This enables them to capture two modes of consumer behaviour - buying online after experiencing the product in-store and buying in-store after browsing and researching the product online. So far the dominant pathway to omni-channel retailing has been for traditional operators to establish online platforms. However we are now also seeing pure-play e-tailers migrating to an omni-channel approach by opening physical stores (e.g. Hotel Chocolat, Missguided).

Traditional Franchise Model Faces Challenges – Franchisees will seek to capture some share of online sales in respect of the crucial role the face-to-face retail channel plays in marketing products and brand values. However the difficulty of apportioning online sales to individual retail units or even regions makes this an inherently challenging model to administer.

Evolving Role of the Physical Store – The functions of the physical store are changing. In some cases shops are being reconfigured to facilitate click & collect. But, equally, many stores are being reimagined as locations where customers can experience the brand and, in some cases, where products can be tried and tested with the assistance of technological tools like magic mirrors, body scanning etc.. Pervasive mobile technology is blurring the lines between the online and physical channels with the in-store experience becoming more automated and customised through technology.

Experience Shopping – In part this reflects the evolution of retail spaces as environments that reflect and promote the brand values. But, the nature of shopping itself is also changing from a functional activity to a recreational pursuit in its own right. Reflecting this, food and beverage (F&B) and leisure uses are expanding within the retail mix as investors seek to increase customer dwell time and extend the hours of activity within retail locations.

The increasing synergy between online and offline platforms may ultimately translate into demand for fewer stores among larger brands (excluding convenience retailing), but with a greater focus on large units in destination locations which enhance the brand image.

Lettings

Despite favourable conditions in the domestic economy retailers which would normally be expanding are less confident than might be expected. The reason is that many traders which occupy prime retail space in Ireland are international brands which are naturally influenced by conditions in their home markets. Many are UK companies, or at least have their regional headquarters in Britain. The uncertainties created by Brexit and the slowdown in UK economic growth make it more challenging for these players to argue a business case for entering or expanding in Ireland. The fact that many retailers are still figuring out their optimum omni-channel approach and are investing in their online platforms creates a further challenge.

Food and Beverage - There has been strong expansion by a number of F&B brands in city centre and strong suburban locations. An array of high quality indigenous brands have emerged to improve the quality and range of offers available in the market. These include Sprout & Co., Chopped, Bunsen, Wowburger and Boojum. A number of international brands are also keen to enter this market including The Ivy, Le Pain Quotidien and Vapiano. While much of the recent letting activity has been in high street locations, shopping centre landlords are engaging in asset management initiatives to create the spaces and environment to accommodate the best F&B players. These offer opportunities for landlords to create more engaging shopping destinations, to increase customer dwell time and maximise the returns on non-prime mall space.

Non-Fashion Stores - Shops selling affordable, tactile, non-fashion items aimed at the Instagram generation have also emerged as a major growth segment in the market. Examples include Flying Tiger, Sostrene Grene and the Australian stationery store Smiggle which has recently opened in Dundrum, Blanchardstown and Foyleside in Derry, and is soon to enter the Cork market. These retailers offer a quirky volume driven and impulse-led retail proposition that is perceived to be resistant to direct online competition.

TABLE 1:
Recent Lettings

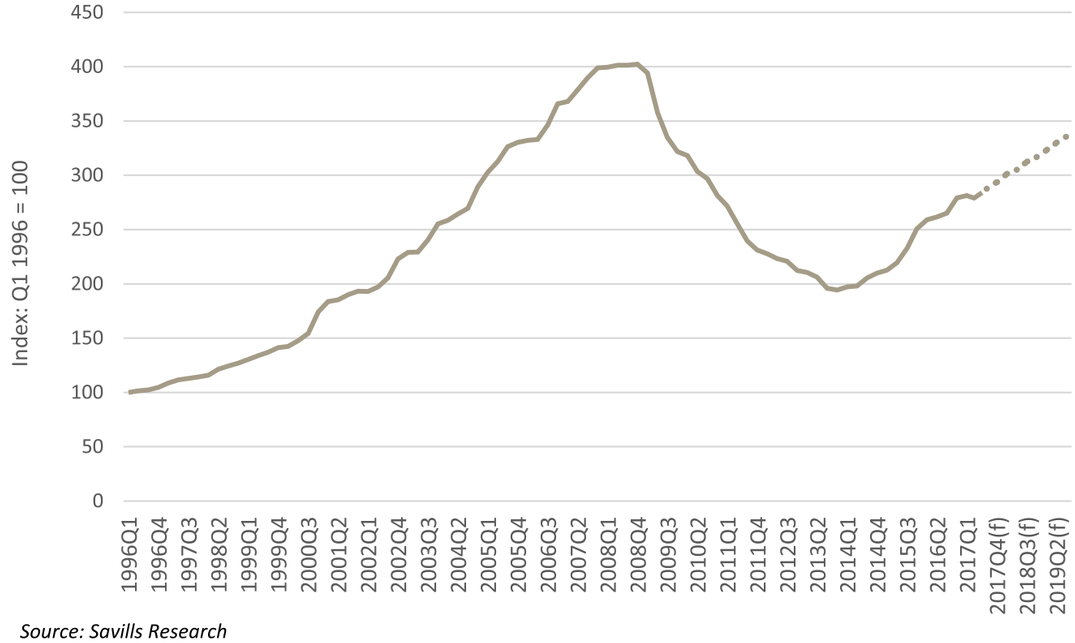
Grafton Street area	Urban Decay, Claddagh Jewellers
Henry Street area	Hotel Chocolat, Sports Direct, Elverys
Jervis Shopping Centre	Top Shop, Best Menswear, Yankee Candle
Dundrum Town Centre	Moss Bros, Hotel Chocolat
Blanchardstown Shopping Centre	Ann Summers, Smiggle, Krispy Kreme
Liffey Valley Shopping Centre	Superdrug, Inglot
Pavillions, Swords	Gino's
Northern Ireland	The Range – Derry & Belfast; Smiggle – Derry; Lush – Belfast
Cork	Rachel Allen's Restaurant Newbridge Sliverware, Specsavers & Smiggle – Mahon Point

Rents

Our econometric modelling shows that jobs growth is ultimately the strongest driver of growth in retail rents. With Ireland's economy now creating nearly 70,000 additional jobs per annum, and with the labour market performing better than at any time in the last decade, we should continue to see retail rents rise over the medium term. In the short term this relationship may be complicated by recent global uncertainties. But, as the reality of events like Brexit becomes internalised and accepted as an ongoing part of the economic landscape, commerce will have to continue as normal and retail rents should trend higher.

For now this is the case and retail rents continue to rise, albeit at a more moderate pace over the last 18 monhts. In part the moderation in rental growth might reflect the uncertainties alluded to above. But as rental increases have compounded since the low-water-mark in late 2013 it is also natural that the percentage growth rate should slow due to a base effect. The MSCI overall ERV index is currently rising at a rate of 5.1% per annum. High street rents in prime city centre locations continue to grow more quickly, with Grafton St. ERVs rising by 9% in the year to June. As a result, Zone A rents in this location currently stand at approximately €6,000 per sq m. Our econometric forecasting model predicts that Grafton St. rents will rise by a further 20.5% compound over the period Q3 2017 - Q3 2019 inclusive. This equates to average rental growth of 7.7% per annum with growth of 7.5% predicted at the furthest horizon of the forecast window (see Figure 3).

FIGURE 3:
Grafton Street Rents Forecast Q3 2017 – Q3 2017



Source: Savills Research

OUTLOOK

Most indicators on Ireland's retail economy dashboard are pointing in a strongly positive direction. The population is growing rapidly, we are approaching full employment, earnings are picking-up and the heavy lifting of fiscal adjustment has been done, providing a more stable economic outlook and the promise of an easing tax burden. Additionally light rail works which have disrupted trade in some of Dublin's prime retail streets will conclude shortly, greatly enhancing these locations as retail destinations. Ultimately, all of this will translate into increased demand for retail space. Given continued international uncertainty and the globalised nature of modern retail, this might not feed through in a smooth process. However, despite some external headwinds, we are continuing to see international brands enter Ireland with more waiting in the wings such as Uniqlo, Dyson and Rituals.

Although there is now a pipeline of retail development the scale of this is relatively limited and delivery remains some way off. Therefore the rental outlook remains positive, particularly for units in prime city centre high streets and the major suburban malls.

TABLE 2:
Consumer Economy Dashboard

Indicator	Period	% Change Y/Y
Live Register	July 2017	-14.0
Real VAT Receipts	July 2017	+10.3
O'Connell Street Footfall	Wks 1-32 2017	+8.8
Real GNP	Q1 2017	+7.9
Core (ex. Motors) Retail Sales	July 2017	+7.0
Real GDP	Q1 2017	+6.1
Consumer Credit Outstanding Balances	June 2017	+5.9
Consumer Sentiment	July 2017	+5.5
Total Employment	Q1 2017	+3.5
Real Average Gross Earnings	Q2 2017	+2.6
Real Personal Consumption Expenditure	Q1 2017	+1.8
Grafton Street Footfall	Wks 1-32 2017	-1.5
Henry Street Footfall	Wks 1-32 2017	-4.8

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