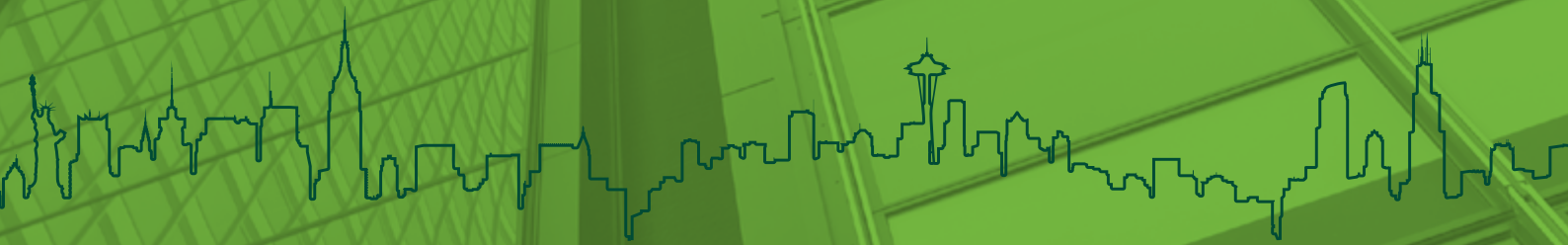


CBRE RESEARCH

2018 U.S.  
**REAL ESTATE  
MARKET  
OUTLOOK**

**Retail**



**CBRE**

## INTRODUCTION



**SPENCER G. LEVY**  
*Head of Research  
& Senior Economic  
Advisor, Americas*

CBRE Research

Despite continued economic growth, the outlook for commercial real estate in 2018 is cloudy as the cycle enters its late stages, with policy uncertainty—particularly regarding corporate tax reform and the direction of interest rates—looming large. In times like these, “agility” is more important than ever for investors and occupiers.

### **RETAIL: AGILE BY MARKET**

Retail’s biggest disruptor isn’t e-commerce; it is demographics. Most big-box retailer closings have occurred in secondary markets, some of which have seen declines in both population and wealth. While high-density markets have not been immune to retail disruption, they have been better able to re-tenant and evolve. Technology has made retail easier, cheaper and faster, but has not changed how people like to make shopping decisions in-store. Take full advantage of the current capital markets weakness in retail and buy in areas with strong demographics.

### **INDUSTRIAL: AGILE BY ASSET TYPE**

Big-box warehouses are in their golden era, from tenant and capital demand perspectives. The good news is that all megatrends point to this continuing, but it has gotten to be very expensive to build or buy big-box. The better news is that the golden era of industrial is now expanding into smaller, last-mile facilities near high-density urban centers, and this opportunity is only now garnering institutional attention. Institutional-grade industrial real estate doesn’t have to be big-box anymore. It can be a strategically located box and, with omnichannel, it may not be “industrial” at all, but a hybrid retail/industrial facility.

### **OFFICE, MULTIFAMILY: AGILE BY CAPITAL STRUCTURE**

The best-performing markets of the current expansion include some that can be highly volatile in a downturn, such as Austin, Boston and San Francisco. But don’t panic in the event of a market pullback. Rather, make your capital structure bulletproof. This includes extending your existing debt to five years or more so you’re not subject to a liquidity crunch. It also involves active communication with your equity partners about what may be required during the downturn, including spending more money. Given the historic cyclicity of our industry, the best time to spend is during a downturn. Don’t pull back on spending and don’t jump the gun on selling in these great and dynamic markets. Create an agile debt and equity capital stack to best position your assets.

### **OCCUPIER: AGILE BY PORTFOLIO FLEXIBILITY**

Large occupiers need to think about agility in both individual-market and portfolio terms, including the length of leases, options to expand or contract space, and the availability of talent. Double down on commercial real estate in those submarkets where you expect to attract, retain and create pools of talent for your business. The current labor shortage in the U.S. is only going to get worse. The very low national unemployment rate is 50% lower in many of the high-skill trades. While agility protects your downside risk/cost overall, don’t put all your eggs in the “save money” basket. Rather, put many of your scarce resources into the “make money” basket of markets with deep talent pools.

Agility is the key in markets with unusual uncertainty.

A woman with long blonde hair, wearing a black sleeveless dress and a black wide-brimmed hat, is looking down at a piece of jewelry on a wooden counter. In the background, there is a man in a dark jacket and glasses, and a well-stocked boutique with shelves of various items, including books, plants, and decorative objects. The scene is brightly lit and has a warm, inviting atmosphere.

# RETAIL

## RETAIL

Changing demographics, consumer expectations and omnichannel retailing will continue to reshape retail and its real estate environment in 2018. As consumer demand for low prices increases, growth in the off-price and discount sector will mark the online and offline retail environments. In the brick-and-mortar space, a growing performance gap between “prime” and “non-prime” assets, driven in part by some increases in retail vacancy, will create opportunities for bullish investors to obtain well-located assets at reduced prices.

Across retail segments, the evolving relationship between landlords and retailers will generate new partnerships to drive traffic and sales. Partially insulated from exposure to e-commerce, grocery stores and building material & garden supply centers should continue to perform better than other segments. Topping the national list for forecast rent growth are dynamic, high-population-growth and low-unemployment markets in the South and West, where demand will outpace supply.

### **CONTINUED GROWTH IN DISCOUNT AND OFF-PRICE RETAIL**

The consumer trend toward off-price and discount retail will continue in 2018, with mid-range retailers seeking new ways to limit share losses to lower-priced players. Since the 2008 recession, greater consumer access to lower-priced goods—especially in key soft-goods categories like apparel and with the expansion of key discount and value retail brands—has shifted consumer spending among all age groups toward lower-priced options. This has placed significant pricing pressures on retailers in the mid-price range, who struggle to compete with the quality and brand cachet of luxury brands and the value offered by low-price players. In 2018, we anticipate many of these mid-range brands to focus on lower prices and discounting in a bid to retain customer share and adapt to new price expectations of consumers.

### **OPPORTUNITIES TO REPOSITION FLAGGING RETAIL CENTERS**

The performance gap between well-located, prime retail assets and those considered “non-prime” (primarily B markets and below) will continue to grow in 2018, reflected in both rent levels and cap rates. In some markets, however, price declines will create opportunities for investors to capture assets with

medium- and long-term growth potential at lower prices. Although negative headlines are driving low opinion of the viability of malls and strip centers in B markets, these fears are disproportionate to the growth potential in some sectors and markets, where owners who renovate or re-lease assets can increase their value. Active investors should focus on demographic trends—population density and growth, jobs and income—and due diligence to properly assess market potential, but pricing changes will create new opportunities for strategic investments in 2018. This may involve adding non-traditional retailers that drive foot traffic, such as state agencies, or converting second floors to office space.

### **GROWTH IN RETAILER-LANDLORD PARTNERSHIPS**

Partnerships between retailers and landlords will increase in 2018. Several factors will contribute to this trend: retailers demanding more flexibility in lease lengths and terms, landlords looking for ways to ensure the long-term viability of their tenants, and both sides seeking new ways to drive traffic and sales in brick-and-mortar stores. As omnichannel continues to evolve in 2018, retailers and landlords will realize that working together through shared data, marketing and other initiatives is more effective than working apart. We expect to see new and more prominent examples of this partnership trend next year, with landlords investing more in new retail concepts through incubator initiatives. Data sharing between retail tenants and landlords—especially in the mall segment—in key areas like traffic and sales will increase, as both sides seek to improve revenue and marketing effectiveness.

### **STRONG RENT GROWTH EXPECTED FOR SOME NON-GATEWAY MARKETS**

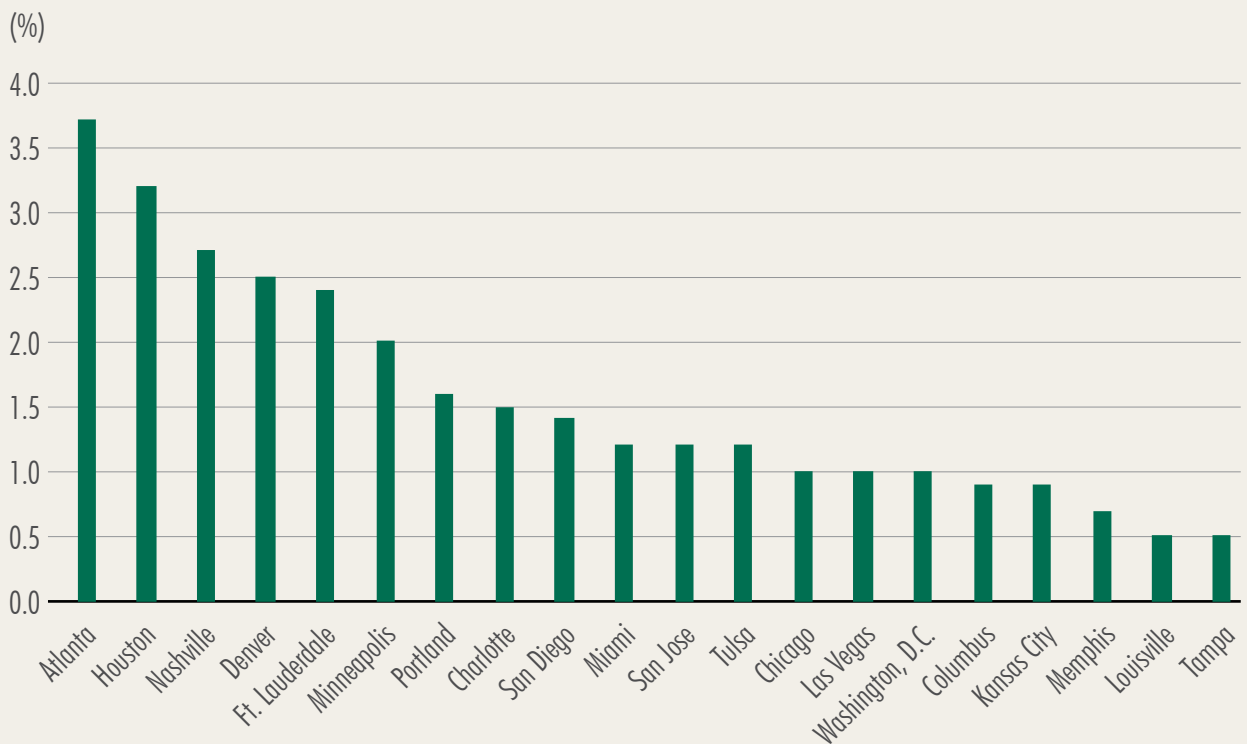
Non-gateway markets like Atlanta, Houston, Nashville and Denver should see rent growth of at least 2.5% over the next five years, as demand outpaces supply. Successful redevelopment in the urban core and a rise in mixed-use projects in the suburbs, together with strong employment and population growth, make these markets especially attractive to investors. Major gateway markets like Washington, D.C. and Chicago, where demographic and demand growth are steady but less robust, are expected to see rents grow, but at a more moderate pace.

## RETAIL

Potential demand for each retail center type can be forecast using local retail employment growth projections. Due largely to closures, department store employment dropped by 3% in the past year—a trend that is expected to continue. Other

segments with weak employment-growth forecasts include apparel, sporting goods and electronics, while healthy employment growth is expected for grocery stores and building materials & garden supply stores.

**FIGURE 15: ANNUAL RENT GROWTH BY METRO, NEXT 5 YEARS**



Source: CBRE Econometric Advisors, Q3 2017.

# CONTACTS

**Anthony Buono**

*Chairman, Global Retail  
Executive Committee*

Retail Services, Global  
+1 619 696 8302  
anthony.buono@cbre.com

**Todd Caruso**

*Senior Managing Director*

Retail Agency Services,  
Americas

+1 847 572 1480  
todd.caruso@cbre.com

**Brandon Famous**

*Senior Managing Director*

Retail Occupier Advisory &  
Transaction Services,  
Americas

+1 215 279 9780  
bandon.famous@cbre.com

**Mickey Ashmore**

*Chairman, Americas*

Retail Services

+1 214 252 1125  
mickey.ashmore@cbre.com

**Mark Bratt**

*Senior Managing Director*

Capital Markets, Retail

+ 720 528 6520  
mark.bratt@cbre.com

**Spencer G. Levy**

*Americas Head of Research &  
Senior Economic Advisor*

+1 617 912 5236  
spencer.levy@cbre.com  
Twitter: [@SpencerGLEvy](#)  
Follow Spencer on [LinkedIn](#)

**Melina Cordero**

*Americas Head of Retail Research*

+1 202 585 5532  
melina.cordero@cbre.com  
Twitter: [@melinascordero](#)

**Jing Ren**

*Economist*

CBRE Econometric Advisors  
+1 617 912 5228  
jing.ren@cbre.com

**Wei Luo**

*Research Analyst*

+1 212 984 8153  
wei.luo@cbre.com

To learn more about CBRE Research, or to access additional research reports, please visit the Global Research Gateway at [www.cbre.com/research](http://www.cbre.com/research).

Additional U.S. Research from CBRE can be found [here](#).

Disclaimer: Information contained herein, including projections, has been obtained from sources believed to be reliable. While we do not doubt its accuracy, we have not verified it and make no guarantee, warranty or representation about it. It is your responsibility to confirm independently its accuracy and completeness. This information is presented exclusively for use by CBRE clients and professionals and all rights to the material are reserved and cannot be reproduced without prior written permission of CBRE.

The logo for CBRE, consisting of the letters 'CBRE' in a bold, green, sans-serif font.