RETAIL INDEX

OUT-OF-FAVOR RETAIL SECTOR MAY OFFER OPPORTUNITIES FOR HIGHER YIELD

Concerns for Retail have not abated, as reflected in the second quarter 2019 returns. Following a strong first quarter during which Retail was second only to Industrial in total return, Retail lagged the other property types in 2Q19. With a total return of -0.11%, Retail returns were reduced by the -1.25% Appreciation component, reflecting a gradual trend of marking retail assets to market. Retail Appreciation for the one-year period was the lowest of the five property types at -2.82%.

Retail Income, at 1.14% in 2Q19, remained relatively steady over the past five quarters. Indeed, it surpassed both Apartment and Office Income returns for the quarter and the year. However, Retail Income returns were not enough to offset the weakness in Appreciation. This resulted in a last place showing for the year as total returns for Retail came in at 1.75%.

Although the Midwest region represents the lowest percentage of asset value at 9.8%, it had a major effect on total returns. Midwest returns were the lowest among the four regions, with a total return of -1.55% for the quarter and -2.62% for the year. Retail Appreciation returns were negative for all regions, but particularly for the Midwest at -2.69% for the quarter, and -6.98% for the year. This probably reflected property tax uncertainty in midwestern states. Increased tax expense suppresses rent growth as tax reimbursement payments increase.

Every Retail Subtype experienced negative Appreciation for the quarter, and only Neighborhood Centers experienced positive appreciation for the year. CoStar has noted that investors divesting of retail property holdings is causing appreciation to flatten. Regional and Super-Regional Centers experienced the most significant Appreciation declines at -5.58% and -3.63%, respectively. Because these subsectors represent 51.5% of Retail market value, they have a major effect on performance. Apprehension towards Regional and Super-Regional Centers will likely continue because these centers have more apparel exposure and experience a greater impact from store closures and negative headlines.

Retail has become a bifurcated market with higher quality centers exhibiting strong fundamentals, particularly those with popular value-oriented retailers and higher food/beverage and fitness/health/beauty components. Power and Community Centers experienced the highest Income returns among the Retail subtypes, both for the quarter and the year. In fact, the Income returns for Power and Community Centers exceeded the Income returns for all property types in the broader index except for Hotel.

Investors continue to approach Retail with trepidation as reflected in the pricing of assets by the capital markets. This Retail value dislocation could present a buying opportunity for disciplined investors seeking higher yields but would require a narrowing of the bid/ask spread. Store closing announcements continue, but there are no surprises as closures continue among weak retailers and in weak or mediocre centers. The labor market remains strong, wage growth has accelerated, and consumer spending, while moderating, remains robust. Ecommerce and physical stores are not mutually exclusive as retail stores provide efficient distribution channels for ecommerce, and digitally native retailers see the need for physical stores to grow revenue and scale.

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RETAIL TOTAL RETURNS

	Total NPI	Total Retail	East	Midwest	South	West
2nd Q 2019	1.51	-0.11	-0.66	-1.55	0.50	0.19
1st Q 2019	1.80	1.74	1.62	0.63	1.95	1.94
One Year	6.51	1.75	0.51	-2.62	2.34	3.20
Three Years	6.89	4.38	3.14	2.08	4.81	5.53
Five Years	8.83	7.70	6.51	5.85	8.40	8.56
Ten Years	9.25	9.23	8.35	7.92	9.90	9.80
Twenty Years	8.88	9.86	9.44	8.38	9.75	10.78

RETAIL INCOME RETURNS

	Total NPI	Total Retail	East	Midwest	South	West
2nd Q 2019	1.12	1.14	1.17	1.14	1.17	1.10
1st Q 2019	1.11	1.16	1.17	1.12	1.24	1.11
One Year	4.53	4.67	4.81	4.60	4.87	4.48
Three Years	4.62	4.70	4.80	4.73	4.82	4.55
Five Years	4.79	4.90	4.99	4.97	4.99	4.74
Ten Years	5.42	5.65	5.68	5.81	5.80	5.46
Twenty Years	6.29	6.52	6.56	6.64	6.57	6.41

RETAIL APPRECIATION RETURNS

	Total NPI	Total Retail	East	Midwest	South	West
2nd Q 2019	0.38	-1.25	-1.84	-2.69	-0.67	-0.91
1st Q 2019	0.69	0.58	0.45	-0.49	0.71	0.83
One Year	1.91	-2.82	-4.15	-6.98	-2.44	-1.23
Three Years	2.19	-0.30	-1.60	-2.56	-0.01	0.95
Five Years	3.90	2.71	1.47	0.85	3.29	3.69
Ten Years	3.68	3.43	2.56	2.02	3.93	4.16
Twenty Years	2.46	3.18	2.75	1.66	3.03	4.17

RETAIL INDEX—QUARTILE RANGE OF RETURNS