A double-edged sword

What the national living wage and business rates review means for the UK retail sector

M&G REAL ESTATE

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Contents

Executive summary

The introduction of the National Living Wage (NLW) in April 2016 and the resetting of business rates in April 2017 have ramifications for the UK retail market. But just what exactly remains unclear, not least in the case of the living wage. This paper aims to offer some early pointers.

The announcement of the NLW in the 2015 Budget came as something of a surprise and is expected to boost the wages of approximately 6 million over-25s, many of whom work in the retail sector – Britain's biggest private sector employer. However, the expected rise in the retail wage bill is unlikely to be a disaster for UK retailers, at least in the short-term, and could boost spending too.

Meanwhile, business rates – a tax charged on most non-domestic properties in England and Wales – are due a much-anticipated and long-delayed review in April 2017 after a lengthy gap during which commercial property valuations have undergone considerable change.

Businesses in UK towns, cities, and regions that have seen a rise in rents since 2008 – in some cases very sharply – will face increases in their rates bill, while those in areas in which rental values have fallen will see a decline.

That could have repercussions for their commercial landlords as it may affect the level of rent that they are willing or able to pay going forward. The relationship between business rates and subsequent rents is strongest in the retail sector, according to a report by Regeneris Consulting.[1]

This report will try to explore whether the NLW and the business rates review will drag on the UK retail sector, which has already faced structural change as a result of the growth in online retailing. According to the British Retail Consortium, the two factors together could potentially add £14 billion to the retail industry's costs over the next four years. Given that retail accounts for the highest proportion of the UK commercial property universe, that is not something that real estate investors should overlook.

But some locations are better placed than others to adapt to the looming changes, whether that means taking advantage of lower business rates or absorbing the higher wage costs. Cities with a relatively high concentration of low-paid workers could also benefit disproportionately from the NLW, leading to increased consumer spending.

So we expect there to be winners as well as losers over the next five years. Cities like Liverpool and Exeter, for example, should receive a boost, while others such as Southampton and Guildford face added burdens.

[1] Business Rate: Who Pays and Why it Matters, a report by Regeneris Consulting, December 2015

National Living Wage

The NLW for those aged 25 and over was implemented on 1 April 2016, with those under 25 eligible for the existing minimum wage. The national minimum wage, introduced in 1999 at £3.60 per hour, has been increased on 17 occasions, including the NLW introduction in April 2016. At £7.20, 50p higher than existing minimum wage rate, the NLW represents the largest rise in cash terms. The table below summarises the headline figures:

been in cash terms had it grown in line with a basket of other factors such as GDP or average shop rents. Chart 1, based on analysis carried out by the Low Pay Commission, illustrates this with some additional factors including prime high street shop rents and retail sales[2].

The minimum wage has broadly kept pace with GDP in nominal terms and it has also outstripped retail sales. Still, retailers have tended to manage the rise in the minimum

Table 1: UK hourly minimum wage rates for upper age cohort

	NLW April 2016	Living Wage Foundation Recommendation	October 2015 Minimum Wage
UK	£7.20	£8.25	£6.70
London	£7.20	£9.40	£6.70

Source: ONS, figures represent wages on an hourly rate

wage by introducing greater flexibility in hours and more part-time roles and by reducing benefits.

The difference between the Living Wage as recommended by the Living Wage Foundation, the rate reflected in the middle column of Table 1, and the NLW is that the latter has become a legal requirement on employers effectively enshrined in national minimum wage legislation.

The Living Wage promoted by the Living Wage Foundation is a best-practice approach that, in the view of the Foundation, all businesses should follow, and indeed some UK companies are already doing so.

The NLW is also, unlike the minimum wage, subject to a future target of approximately £9.00 (contingent on nominal GDP and wage growth) to be achieved by 2020. Indeed many employers in London are currently paying the Foundation's higher rate including GlaxoSmithKline, KPMG, and Barclays.

An interesting way to analyse the growth in the minimum wage since it was introduced is to examine what its trajectory might have

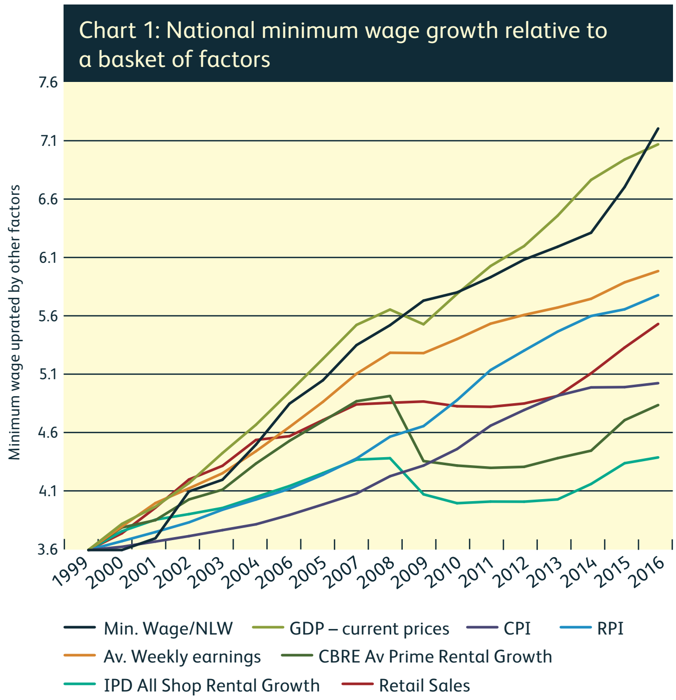
Given the pressures the sector is facing – price competition, omni-channel strategies, and now the uncertainty posed by Brexit – it is perhaps easy to conclude that the NLW is likely to further damage an already-fragile sector.

The NLW reflects a 7.5% increase on the previous headline minimum wage rate. Further growth of 25% (or roughly 6% p.a.) is anticipated based on the target of £9.00 by 2020.

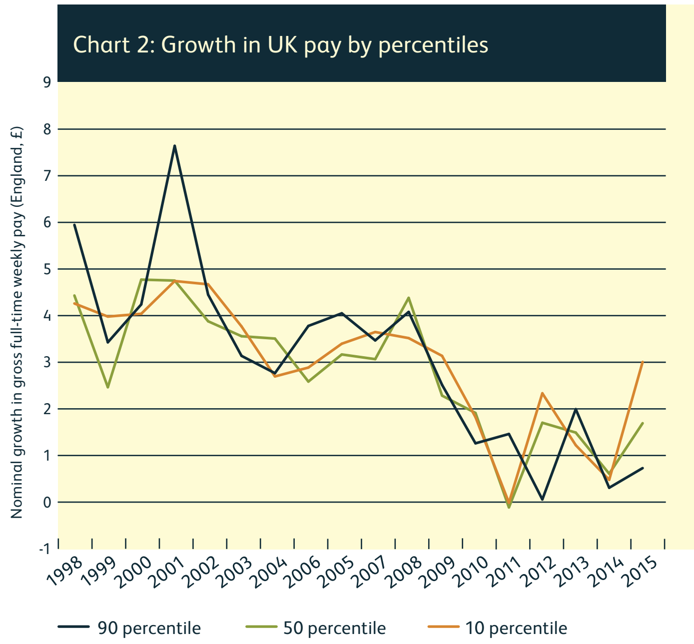
When assessed in the context of average wage growth over the past 10 years, the growth required to reach this target will have a disproportionate impact on business costs — so much so that it has the potential to move the needle for many companies.

"...retailers have tended to manage the rise in the minimum wage by introducing greater flexibility in hours and more part-time roles and by reducing benefits."

[2] About the National Minimum Wage (NMW), Low Pay Commission, 2014



Source: ONS, Nomis



Source: LPC, ONS, CBRE, Experian, M&G Real Estate

Chart 1 rebases a number of other factors to the point in 1999 when the minimum wage was introduced at £3.60 per hour and shows that minimum wage growth has broadly matched GDP growth in the intervening period. However, the broader trend over the same period is that nominal wage growth has decelerated, with the most recent slowdown occurring since the global financial crisis.

Chart 2 shows the growth in nominal gross weekly earnings for the lowest 10 percentile (including those paid the minimum wage) and the top 90 percentile. Growth in weekly wages for the bottom 10 percentile have largely kept pace with the top 90 percentile.

So wage pressure more generally has eased, helping to reduce the overall share of profits to labour.

According to ONS data for April-June 2016, approximately 70% of sales and customer service occupations are employed on a part-time basis.

That is considerably higher than leisure and travel, where part-time employees only constitute 40% of the total. This high proportion of part-time workers in the retail sector, which also includes 42% of all working 16-17 year olds, creates exceptional flexibility.

Still, for retailers customer experience is a major selling point that helps to differentiate the physical in-store shopper experience from simply shopping online. As a result it is likely that retail operators will seek to manage costs through pricing strategies before reducing headcount, at least on the shop floor.

Large multiple retailers such as Next, Marks & Spencer (M&S), and Whitbread are very exposed to minimum wage changes.

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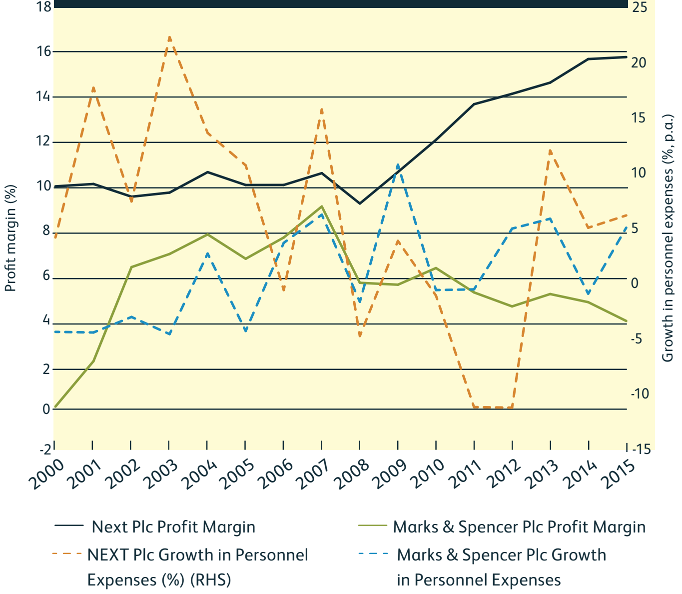
Chart 3 overleaf shows profit margins and personnel expenses for two of the larger UK retailers, Next and M&S. While Next have managed their expenses down and profits have expanded, M&S's expenses have trended higher and their profits have declined.

Chart 3: Next Plc and Marks & Spencer Net Profit and Personnel Expenses 1999-2015



Source: Bloomberg, Company Annual Reports

These companies are both significant employers of a large number of minimum wage staff and yet both have grown their net physical footprint over the past 15 years.

While many factors have influenced profit margins, both companies have been able to maintain positive margins since the inception of the minimum wage and, in the case of Next, have managed their expenses quite efficiently. Next has demonstrated that a business can be successful and expansionary in a rising cost environment.

A rising retail wage bill

As illustrated in Chart 3, different companies have approached labour and other costs differently. Strategies to manage costs may include lower profits, less labour employed, reduced total compensation packages, and price rises.

In the short run, price rises appear the most likely outcome but these are arguably less easy to implement than 10 years ago, because of the rise in non-seasonal discounting, which consumers may have now come to regard as normal. So productivity, measured by output per worker per hour, will have to rise if profitability is to be boosted.

Having said that, Whitbread in the case of their Costa Coffee business, have stated that they intend to manage the increase in personnel expenses by raising the price of hot beverages. Indeed, Resolution Foundation have suggested that the hospitality sector has in the past used modest price rises to manage rising wage costs.

"Next has demonstrated that a business can be successful and expansionary in a rising cost environment."

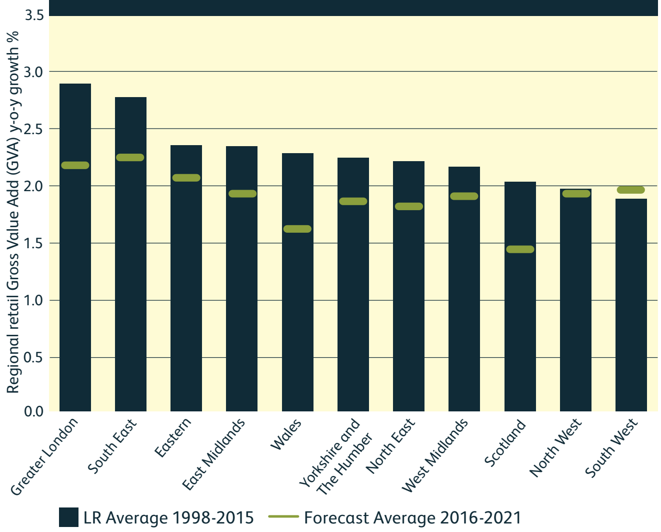
Brexit throws another set of issues into the mix, potentially weaker consumer spending but also a weaker pound, which disproportionately affects fashion and electronics buyers as these goods tend to be imported. An environment with rising cost of goods and weaker GDP growth, resulting in stagflation, would be a worst-case scenario. However, while the outlook for UK growth has been downgraded and the weaker sterling has increased inflation forecasts, neither a recessionary nor stagflationary scenario is expected.

Next is an example of a larger retailer, employing over 47,000 staff in the UK. Employee costs per head at Next have fallen markedly since the end of 2013, by about 40%, while over the same period store numbers have grown, as has the average size of these stores.

In their 2015 Annual Report, Next acknowledge that their costs have been rising and highlight their efforts to better manage them.

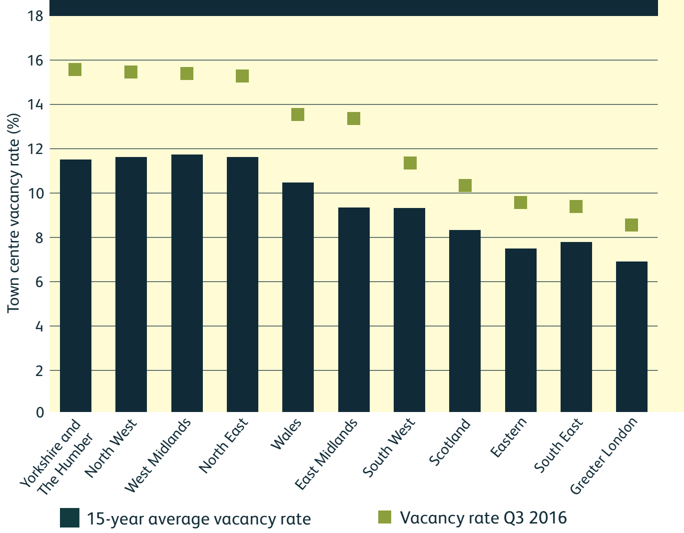
Cost of living awards and wage-related inflation featured amongst the largest cost increases, constituting approximately 46% of total costs.

Chart 4: Regional retail gross value-add



Source: Experian

Chart 5: Regional town centre vacancy rates



Source: PMA

In hierarchical terms, wage costs are followed by rents, rates, and other occupier costs. Savings have been made through a reduction in senior management costs and staff incentives. Thus, while their total footprint as measured by net store openings has grown Next, has long had a cost-control programme in place. This arguably highlights one relatively successful way by which NLW could be managed by other companies.

"According to PMA town centre vacancy data, a clear north/south divide exists."

Chart 4 shows the long run average retail sector gross value-add (GVA) growth compared with the expected growth in retail GVA over the next five years. Here, GVA measures the total sales less the cost of goods and intermediate inputs excluding labour for each region.

Over the next five years only two regions (Wales & Scotland) are expected to average annual retail sales growth below 2.0%. Elsewhere the outlook for retail sales is relatively robust, despite the projected headwinds from Brexit.

From a retail property perspective we expect there to be regional winners and losers over the next five years. As we shall see later, marginalised locations may see falls in rateable values at the next business rate review, providing respite for those markets where retailer demand has been weak.

In the short-run, where there is a high concentration of employees who benefit from the NLW this may actually prove to be a fillip for the local retail catchment, adding greater consumer spending power in those regions with the poorest fundamentals.

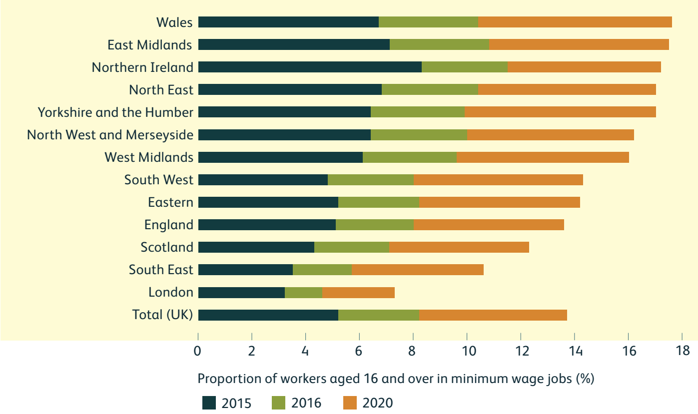
According to PMA town centre vacancy data, a clear north/south divide exists. Vacancy rates have a direct negative impact on rental growth and, in the case where high vacancies persist, the ability of town centres to attract a diverse mix of retailers.

Of course these regional rates mask specific local market conditions. For example, in the North East and North West there are strong cities such as Newcastle and Manchester that have well-diversified and vibrant high streets that also incorporate major shopping centres. Liverpool is a major city with weaker socio-economic fundamentals, yet it also retains a relatively strong retail offering.

Chart 6 illustrates the regions with the greatest potential growth in NLW employees by 2020. In the UK by the end of 2016 it is estimated that the number of employees paid the minimum or NLW, as a share of total employment, will have increased from 5.2% to 8.2% and by 2020 will be just under 14%.

It is estimated that by 2020 Wales, Yorkshire and the Humber, the East Midlands, and the North East will be the regions with the greatest increase in workers paid the minimum wage. London is expected to have the lowest followed by the South East and Scotland.

Chart 6: NMW/NLW coverage for workers aged 16 and over



Source: Low Pay Commission (LPC) (LPC uses Office for Budget Responsibility (OBR) forecasts for 2020)

According to the Resolution Foundation, there was little evidence with the previous minimum wage framework to suggest it caused unemployment to rise in low-wage areas of the UK.

Comparing the regional proportion of minimum wage workers to regional vacancy rates as well as retail sales performance shows some overlap. Again a North-South divide emerges, implying that the wealthier South facilitates stronger retail growth and therefore a lower vacancy rate compared with the Midlands and North. However, this probably over simplifies what are complex local market dynamics.

With no compelling evidence as yet to show that minimum wage growth leads to higher unemployment, it is difficult to be too negative. Indeed, there are some grounds to be positive. The marginal propensity to consume is far greater for low-income households, so there is always the potential for a short-term economic gain, and all the more so when it is recalled that wage growth has been decelerating over the past 18 years, meaning labour has received a diminishing share of business profits.

The increase under the NLW, in terms of what it means for businesses, is likely to take time to manifest and will of course be obscured by other events shaping the economy. The projections in Chart 6 are from the Office for Budget Responsibility (OBR) and imply a significant increase in terms of the proportion of UK workers who will be paid the NLW by 2020. Taking the UK as a whole, Chart 6 suggests that 8% of those employed nationally will be paid the NLW, rising to almost 14% by 2020.

"...by 2020 Wales, Yorkshire and the Humber, the East Midlands, and the North East will be the regions with the greatest increase in workers paid the minimum wage."

Since the people who benefit from this jump are low paid, that provides a major financial boost to households on lower and middle incomes, providing a fillip to retail sales.

The business rates review

Business rates are a major source of revenue for the government, generating £22.4 billion for England and Wales and £2.6 billion for Scotland in the 2014/2015 tax year. PwC[3] noted in 2015 that for every pound paid in corporation tax by the UK's 100 largest businesses £4.46 was paid in other taxes.

Over the same period PwC estimated that business rates accounted for approximately 21% of the total taxes borne by the average large business, greater than the 18% in corporation tax but smaller than the 29% in national insurance contributions.

[3] PwC 2015 Annual Tax Contribution Survey for the 100 Group

Significantly, PwC also noted that for the first time since the survey began in 2005, business rates constituted the second-largest tax burden on the country's 100-biggest businesses. In the case of the retailers in this top-100, business rates accounted for on average 51% of the total tax bill.

For large retailers occupying the highest rent space, therefore, any increase in business rate costs will affect the affordability of that space.

Business rates come about through the establishment of a rateable value that is set every five years. The rateable value (set by the Valuation Office Agency) is simply the rent two years prior to revaluation date multiplied by the rate multiplier, sometimes referred to as the Uniform Business Rate (UBR), which increases in line with inflation each year.

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The revaluation that was set for April 2015 (based on April 2013 rents) was delayed and is now scheduled for April 2017 (on April 2015 rents). This will be the first revaluation for seven years, given that the last business rates review occurred in 2010. That, in turn, was based off rental values from the first quarter of 2008.

So the revaluation may result in a relatively large redistribution of the rate burden. Business rates are set to increase for properties where the rental value has risen most between April 2008 and April 2015, while properties that have seen large falls in rental values over this period will see the biggest decreases in their business rates bill.

Given the disconnect between central London's rampant property market and the stagnation seen elsewhere in the country, the readjustment in tax burdens is significant.

As the UK government puts it: "Many ratepayers will see only a small change in their business rates bill at the revaluation. But, some properties will see a more significant change – both increases and reductions."

Transitional relief

As with previous business rate reviews, some transitional relief is expected over the next five years that will allow for increases in business rates to be phased in gradually. The transitional relief consultation report from the Department for Communities and Local Government, from which the above quote is taken, outlines some of the options. Since business rate reviews are revenue-neutral or fixed in real terms – i.e. they enable the government to receive the same amount of money irrespective of tax law changes, the upshot is that the phasing in of sharp increases in, say, central London, means any reductions in the North or Midlands will also have to be tapered.

"Many ratepayers will see only a small change in their business rates bill at the revaluation. But, some properties will see a more significant change – both increases and reductions."

Option 1 provides separate forms of transitional relief for small properties compared with medium-sized or large properties. (Medium-sized properties are defined as having a rateable value of £28,000-£100,000 in London and £20,000-£100,000 outside of London, while large properties have rateable values >£100,000).

Option 2 introduces three separate categories for reductions, covering small, medium and large properties, in effect providing greater relief for medium-sized properties. Where it differs with Option 1 is that for large properties the cap on any rates rise in the first year is set much higher at 45% versus 33%.

In the 2016 Autumn Statement, the government appeared to opt for Option 2 (see Table 2 overleaf), with some minor amendments. The

Table 2: Government Transitional Relief Arrangements – Option 2						
Transitionary Arrangements	Property Size	2017/18	2018/19	2019/20	2020/21	2021/22
Upwards	Small	5.0%	7.5%	10.0%	15.0%	15.0%
Upwards	Medium	12.5%	17.5%	20.0%	25.0%	25.0%
Upwards	Large	45.0%	50.0%	50.0%	16.0%	5.0%
Downwards	Small	20.0%	30.0%	35.0%	55.0%	55.0%
Downwards	Medium	10.0%	15.0%	20.0%	25.0%	25.0%
Downwards	Large	4.1%	4.6%	5.9%	5.8%	4.8%

Source: Department for Communities and Local Government

most salient alteration with respect to Option 2 was a slight lowering to 43% of the cap on the upward rate reviews for large properties in 2017/18, down from the original 45%, but controversially there was no change in the way reductions were to be phased in. These are still limited to 4.1% for the first financial year.

So, in the first place, there is a large disparity between this review's treatment of business rate rises and the last review in 2010, when upward rises were capped at just 12.5% in the first year.

Furthermore, there is a large disparity between the way caps on rises are treated versus any declines in UK rateable values. In short, those businesses set to benefit from the review will reap those benefits only slowly, while those in line to be hit by higher costs will notice the difference more quickly. Therefore, transitional relief may result in a slower rates bill reduction in many parts of the country than is perhaps justified, with those parts that can least afford it potentially subsidising richer areas like London and the South East.

More lobbying of the government and pressure from retail bodies cannot be ruled out in the coming months, which could yet result in further tweaks to transitional arrangements, not least for large properties where the occupants may yield greater influence.

In addition, JLL estimate that the aggregate Uniform Business Rate (UBR) – the multiplier used to determine a tenant's business rates bill based on the rateable value of the property it occupies – will rise to 53.3p per pound of rateable value.

If so, it would be the first time in the modern era that the rating multiplier has increased following a rate revaluation, according to JLL which would offset some of the expected reduction in the business rates burden beyond London. Currently, the large property UBR for England is 50.3p and for London it is 52.3p.

It is possible, however, that the UBR may rise more in London than for the rest of the UK once it is announced in early 2017. According to the government consultation on transitional relief it is estimated that a 14% rate increase on average for London retail in 2017 is equivalent to a £256 million increase in London retail rate bills.

"...there is a large disparity between this review's treatment of business rate rises and the last review in 2010, when upward rises were capped at just 12.5% in the first year."

For the regions, the average decrease estimated for rateable values in 2017 is 12%, with the North East, North West, and South West of England potentially the biggest winners.

Consequently, the outlook for UK retail rental growth looks more promising than it has done for some time; as traditional bricks and mortar retailers struggle to adapt to the online world, a lower business rate bill may prove a fillip to the industry's overall cost base while simultaneously

Table 3: Zone A rents most at risk			
2015 Zone A > (£ sq.ft)	% Sample	Average rent increase since 2008 (%)	
500	3.19	79.52	Most at threat from rate revaluation
250	7.35	27.13	
150	16.91	3.54	
100	14.71	-7.28	Could benefit from redistribution
75	14.46	-17.65	
50	21.81	-21.79	
25	20.59	-21.47	
0	0.98	-22.24	

Source: JLL

making physical locations more affordable for pure play retailers considering expanding into the physical realm.

JLL estimates that retailers in areas which have experienced a fall in rateable values should feel the full benefits of the business rates review within three years.

While it is recognised that business rates are not a panacea for all high street ills outside of central London, a lower cost base and wider demand base may improve rental growth in some markets over the next five years.

Given the changes taking place in this sector, particularly as purer play and physical property retail strategies are blurred, the outlook is perhaps beginning to improve.

Although there are economic headwinds that may act as a drag over the next few years, retail property portfolios should benefit in aggregate. There is already some support for the occupier market from a subdued supply side and, for many locations outside of London, the biggest reduction in business rates in at least 10 years will help to correct an imbalance in many cities and towns where annual business rates bills exceed the cost of rent.

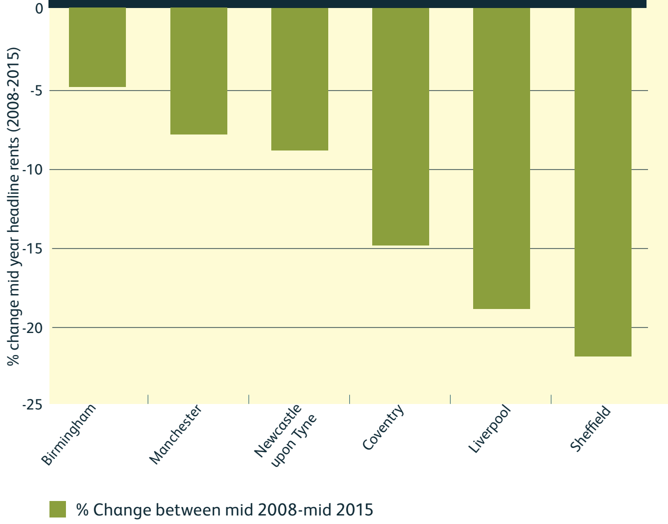
Another significant positive from the business rate review applies to small businesses. The rateable value threshold for England, in terms of small business reliefs, has changed since the budget in April 2016. Small business properties with a rateable value of £12,000 or less are eligible for 100% rate relief – the cap used to be £6,000 – and for those businesses with a property rateable value between £12,000 and £15,000, relief will be tapered.

The government claims that 600,000 small businesses will be lifted out of the rate system, improving their ability to pay rent and other costs.

"While it is recognised that business rates are not a panacea for all high street ills outside of central London, a lower cost base and wider demand base may improve rental growth in some markets over the next five years."

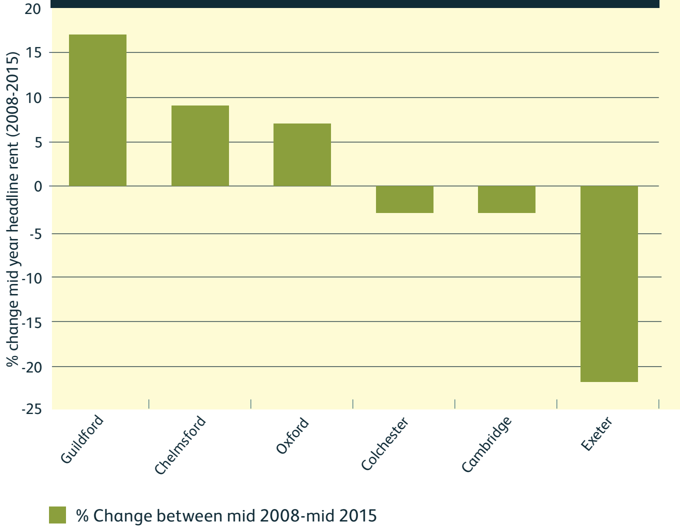
Table 3 above summarises the analysis by JLL and shows that the higher Zone A rents have seen the largest average increases since 2008 and are therefore likely to see the largest increase in rateable values. Zone A rents in many of the core sub-markets in central London were above £250 per square foot in 2015, suggesting that occupiers there will face the steepest rise in their rate bills. Outside of central London, the picture looks more positive, even accounting for a degree of latency from the transitional relief.

Chart 7: Prime shop headline rental growth in select cities in Midlands and North



Source: PMA

Chart 8: Prime shop headline rents in select cities in South and East



Source: PMA

Chart 7 highlights the growth in prime rents across the main locations within the Midlands and Northern England – where overall town centre vacancies are among the highest – that occurred between 2008 and the middle of 2015.

It is worth noting that many of the locations in chart 7 have prime rents above £100 per sq.ft, and that in 2015 headline rents in all of these locations were below where they were in 2008. That suggests that on average the occupiers in these city or town centres will see a significant decline in their rate bill.

According to the Regeneris report, the relationship between business rates and rents appears to be stronger in regional markets such as Newcastle, Birmingham, Manchester, and Liverpool. Regeneris also suggest that London rents appear to be less responsive to rates, pointing out that they are unclear what drives this or whether it is a statistical anomaly. They nonetheless highlight that longer leases and a greater range of stronger economic factors may be responsible.

It is possible, for example, that many retailers have simply accepted the rise in business rates due to the importance of central London as a luxury retail market and major international tourist destination. So central London retail is better able to withstand rising business rates as a result of its unusually strong catchment fundamentals. The picture is more mixed across the South, as Chart 8 illustrates. Many of the stronger, dominant retail locations such as Guildford recorded increases in prime rents between 2008 and 2015. But this masks the diversity of outcomes as seen with Exeter, a strong regional market that suffered badly after the global financial crisis.

The city centre experienced a rise in retailer repositioning and the high street suffered at the expense of a strong in-town shopping centre offering, resulting in falling rents on the high street in the early part of the 2008-2015 period. More recently the city centre has seen vacancy rates reach a new low and modest rental growth return.

> "According to the Regeneris report, the relationship between business rates and rents appears to be stronger in regional markets such as Newcastle, Birmingham, Manchester, and Liverpool."

The Regeneris report concludes that over the long run, where business rates increases are capitalised into rents, this results in lower development capital, i.e. higher rates equate to lower rents over time and this results in less income being reinvested by investors/landlords. Whether that is the case is open to debate, as landlords and investors have to maintain a balancing act between full occupancy and income growth via asset management.

Overall, we would argue that it is not true in the case of prime and strong secondary locations but may become a factor in marginalised, small towns that are impacted by their proximity to locations of relative strength. If the location possesses robust fundamentals and attracts footfall, retailers are typically prepared to pay business rates and rents commensurate to the trading opportunity.

A potential risk for retail landlords, given the uncertainty brought about by Brexit, is more frequent break clauses or increased rent-free periods being introduced into new leases. There is a risk that over the short term landlords may struggle to increase rents. However, if rate reviews are carried out with greater frequency then this could lower investment risk over time by virtue of providing the occupiers with rates that more frequently track the actual changes in rental values and economic growth.

The new exemption of smaller properties from business rates, meaning the removal of an estimated 600,000 businesses from the burden of rates, worth approximately £6.7 billion in local authority revenue over the next five years, does suggest that central London is in for a steep rise to compensate the government for this loss of tax revenue.

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Moreover, with local authorities across the UK set to lose national government funding, any loss in local revenue could really set these locations back. By 2020, it is intended that local councils will be 100% funded by locally raised revenue instead of government grants, with the planned full devolution of business rates being granted to the Greater London Authority as well as potentially Liverpool and Manchester as pilot schemes by April 2017.

Only time will tell whether this will foster greater growth or result in significant gaps in retail provision at a local level.

What it means

The introduction and expected growth of the NLW and the business rates review have big implications for the retail sector. The NLW will result in further costs to a sector that has experienced a period of rapid structural change.

That said, the NLW does not appear unmanageable for retailers as long as their offering remains competitive and they carefully manage their overall cost base as Next appear to have done.

The lack of substantial research on the subject makes it difficult to identify the likely NLW impacts on employment and therefore, indirectly, demand for UK commercial property also.

The ability to raise prices will be testing for all but food and beverage as well as experiential leisure have used price increases in the past, with no noted consequence on their physical footprint.

Overall, where retail fundamentals are weaker it may pose risks, particularly if growth stagnates post Brexit. But, the economic outlook at present does not imply stagflation or recession.

Rising costs are expected to trigger a rise in prices but, with consumer experience more important than ever in this competitive retail environment, it is unlikely to result in significant reductions in staff numbers. Furthermore, for those regions expected to see the greatest rise in the proportion of workers paid the NLW, it may provide a boost to local retailers in the short term.

The polarisation between the North and South is not going to reverse as a result of the business rates review but equally it does not look like it will be exacerbated. The benefits from the review will take time to filter through.

Central London is likely to see the sharpest rises, albeit with possibly less visible effects

Table 4: Selection of potential city winners and losers			
Potential Winners	**NLW High/Low**	**Average % change in prime headline rent mid 2008 – mid 2015**	**5yr Forecast Nominal Rental Growth % p.a.**
Exeter	Low	-22.0	1.6
Liverpool	High	-18.7	2.1
Leeds	High	-18.0	1.2
Birmingham	High	-4.6	2.0
Potential Losers	**NLW High/Low**	**Average % change in prime headline rent mid 2008 – mid 2015**	**5yr Forecast Nominal Rental Growth % p.a.**
Central London sub-markets	Low	53.1	4.8
Guildford	Low	17.0	1.4
Oxford	Low	7.0	0.2
Southampton	Low	9.4	0.3

Source: PMA, M&G Real Estate

in the near term due to transitional relief and the strength of its catchment fundamentals. It may be that in order to maintain a presence in the fundamentally strong London sub-markets, retailers will simply accept higher rates bills.

"...the NLW does not appear unmanageable for retailers as long as their offering remains competitive and they carefully manage their overall cost base as Next appear to have done."

However, over much of the rest of the country lower business rates may act as a draw for retailers. Rising disposable incomes for the lowest income households and more attractive business costs are likely to be a net positive too over the long run.

The benefit extended to the regions from the business rates review is likely to be staggered due to transitional relief, which could potentially begin as UK economic growth moderates. Over the next five years, though, we expect UK GDP growth to revert to a long-run trend of around 2.25% and, outside of London, this could coincide with the lowest property rate bills for the retail sector in a decade.

There are many regional markets where average shop rents have fallen in excess of 5%. While this report has only highlighted a small number of these, some of the largest drops in rents between 2008 and 2015 occurred in the Midlands and North of England.

Southern markets were not immune to falling rents but, on average, have not seen falls of the same magnitude.

Nonetheless, it would be a gross over-simplification to lay too much store by this North-South disparity. What's clearer, as the Regeneris study shows, is that rents in regional cities generally appear to be more responsive to changes in rates than in central London.

"...Exeter and Liverpool are two potential big winners."

Cities and towns with a distinct character and strong surrounding consumer catchments have been more resilient and are, in many cases, likely to continue to be successful, independent of factors such as business rates. But there are also cities that could receive a welcome extra boost from both the NLW rise and business rates review.

As Table 4 above shows, Exeter and Liverpool are two potential big winners.

Exeter falls into the category of a vibrant regional city in a relatively affluent catchment and, despite strong competition for the high street from in-town shopping centres, may become a compelling offer for retailers currently not present.

Liverpool, despite continued competition from Manchester, should benefit from the fillip provided to those on the lowest incomes as a result of the NLW.

> "We believe the 2017 business rate review will go some way toward addressing imbalances between rents and rateable values."

Based on rental value declines of close to 20% between 2008 and 2015 the city should also see many retailers gain relief from a large reduction in their cost base over the next five years.

Given the heterogeneous nature of property, the real winners and losers will vary significantly on an asset by asset basis. Reductions in business rates are clearly not a panacea for many local market troubles nor a guarantee of rental growth.

We believe the 2017 business rate review will go some way toward addressing imbalances between rents and rateable values.

For more information

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