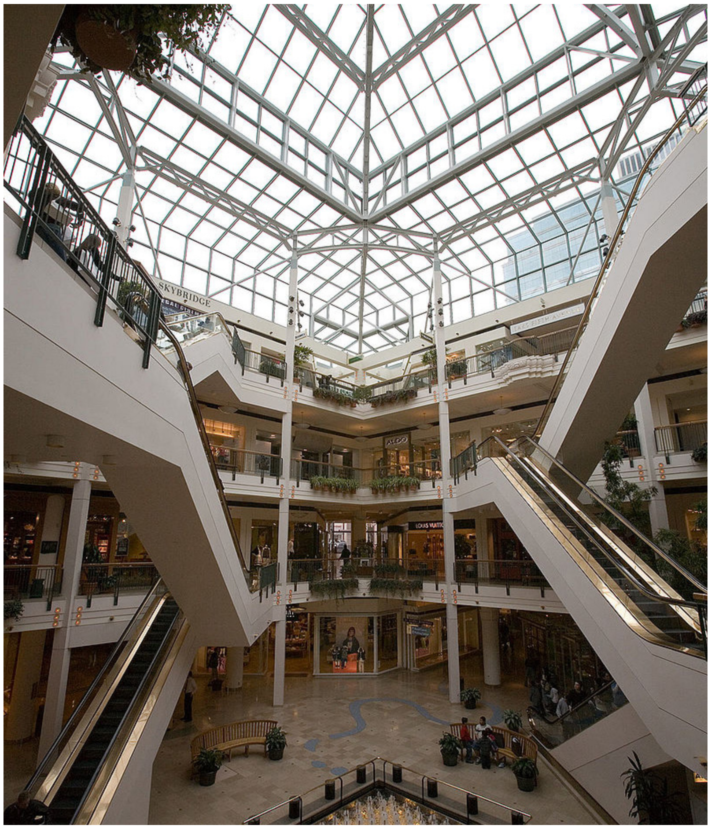
RETAIL MARKET ANALYSIS

RILEY HENDERSON
Portland State University



Despite the doom and gloom warnings of a retail apocalypse, the national story for retail is that things are stable. Nationwide vacancy is at 5.2 percent and rent growth has been holding slightly above 2 percent in the second quarter of 2017, according to CoStar. However signs of a retail market cooling are on the horizon.

CoStar anticipates 20 million square feet of mall space is will go dark this year. This is in addition to the 25 million square feet from Macy's, Sears, and JCPenney that has already closed over the past few years. This has had an impact on the market and will likely push vacancies up further. On the positive side, gym's which were once blacklisted from malls are now being welcomed by landlords and are a great candidate for the big box vacancy. The difficulty with gym leases is that many of the existing leases at a retail center exclude gym operators adding an additional challenge for some landlords who have large vacancies.

The properties that will face the most challenges are those in second and third tier locations. Retailers are looking to shed the underperforming locations and double down on their prime locations as the best course of action against the threat of ecommerce and this strategy appears to be working.

Riley Henderson is a Masters of Real Estate Development candidate through a joint program of Portland State University's School of Business Administration and School of Urban Studies and Planning. In addition, Riley is a commercial broker with NAI Elliott specializing in office leasing. He is the 2017 Oregon Association of Realtors Fellowship recipient. Any opinions expressed are those of the author solely and do not represent the opinions of any other person or entity.

Location as a premium in sales transactions as well. CoStar highlights the pricing disparity between locations by contrasting two General Growth Properties (GGP) that were recently sold. The first property was a premier retail destination known as Fashion Show in Las Vegas. It sold to TIAA-CREF for $1.25 billion at a 3.9 percent cap rate which equates to $1,316 a square foot. Compare this to the sale of Newgate Mall in Orem, UT. A C class mall also owned by GGP that sold for $70 million at an 8.9 percent cap rate which equates to $103 a square foot. The property with a premier location sold at a market premium while the second tier mall sold for a discount. This is a prime example of how properties with irreplaceable locations will continue to outshine their competitors and retain tenants compared to properties that are in less desirable markets.

The retail development pipeline nationally is expected to be about 60 million square feet in 2017, which compared to the 2006 development pipeline of 170 million square feet is significantly less. This should help buffer the negative effects of a downturn on the retail industry.

The other major headline in retail during the second quarter of 2017 was the announcement that Amazon made an offer to purchase Whole Foods. This sent shockwaves through the grocery industry.

Closer to home, the strong regional economy has continued to keep the Portland retail market ahead of the nation. According to The Bureau of Labor Statistics, Oregon's unemployment rate was 3.7 percent in June of this year. Oregon continues to see a strong in-migration and job growth across a variety of industries, all favorable factors to keep Portland's retail market strong.

VACANCY

The Portland retail market experienced a strong 2017 second quarter that was well ahead of the national average. The market wide vacancy rate stayed steady at 4.1 percent according to Kidder Mathews. CoStar reported a vacancy rate of 4.4 percent which is the tightest vacancy rate since 2005. However, the Portland market hasn't been immune to some of the large retail closings that have hit certain properties hard nationwide. Notably, Macy's closed their flagship downtown store and Lloyd Center continues to operate without one of their major anchor tenants after the loss of Nordstrom's. These large vacancies have hurt these properties but the Portland market has by and large been insulated from many of these closings and not allowing them to affect the in-line tenants keeping vacancy rates low.

Table 1: Portland Retail Vacancies by Submarket, Second Quarter 2017

Submarket	Vacancy Rate
CBD	8.9%
Clark County/ Vancouver	5.2%
I-5 Corridor	5.3%
Lloyd District	4.6%
Northeast	3.1%
Northwest	3.0%
Southeast	3.4%
Southwest	4.0%
Sunset Corridor	2.2%
Total	4.1%

Source: Kidder Mathews

VACANCY

Table 2: Portland Retail Vacancies by Product Type, Second Quarter 2017

Property Type	Vacancy Rate
Malls	3.3%
Power Centers	3.9%
Shopping Centers	6.5%
Specialty	0.0%
General Retail	2.5%

Source: Kidder Mathews

ABSORPTION AND LEASING

The Portland market experienced a total of 234,871 square feet of positive net absorption in the quarter according to Kidder Mathews data. There was a fair amount of larger leases inked this quarter including a Hobby Lobby taking down 45,121 square feet of the former Sports Authority in Clackamas. Target took down 32,100 square feet at the former AMF Bowling location and three locations of BFit gym opened taking down a combined total of 61,000 square feet. The activity seen in the suburban submarkets continues to make it the strongest performing retail area in terms of positive net absorption and vacancy rates.

Table 3: Portland Retail Absorption, Second Quarter 2017 and YTD.

Submarket	Q2 2017 Net Absorption	YTD Net Absorption
CBD	(174,414)	(189,396)
Clark County/ Vancouver	75,092	(6,786)
I-5 Corridor	65,941	38,869
Lloyd District	(18,303)	(16,366)
Northeast	44,079	109,759
Northwest	(4,281)	3,613
Southeast	125,806	186,799
Southwest	31,158	3,925
Sunset Corridor	85,583	117,057
Total	234,871	246,948

Source: Kidder Mathews

RENTAL RATES

Rental rate growth market wide has once again surpassed the national average. Rental rates have been growing at an average of 6.2 percent year-over-year compared to the 2 percent growth on national level. Properties in the CBD are quoting an average of $25 a square foot on a triple net (NNN) basis while market wide rents averages around $19.05 NNN, reports Kidder Matthews. Despite the hot growth in rental rates, Portland is still well below other West Coast markets, driving investors to seek value in Portland. CoStar indicates much of the rent growth can be attributed to the low vacancies in the market. As some new projects get out of the ground and are delivered rent growth may slow to some degree.

DELIVERIES AND CONSTRUCTION

In response to the tight vacancies and growing rents, construction has increased slightly and is expected to remain near current levels of supply. Kidder Mathews highlights that there is 317,943 square feet under construction spread across 13 projects. A substantial amount of that is taken up by the expansion of Cedar Hills Crossing which won't do much to alleviate the lack of retail space due to a bulk of the space being taken up by Sunset Lanes and a health center. Additionally there are a number of single tenant developments under construction that accounts for a significant amount of current space under construction.

All in all, a total of thirteen projects were delivered in the second quarter of 2017 totaling 191,053 square feet of retail space. The most notable delivery this quarter was the Hazel Dell Marketplace in Vancouver which is a new community center anchored by Marshalls. Both new deliveries and future supply are expected to be taken down quickly in a market with such a low vacancy rate and little room for expansion or relocation.

Table 4: Notable Retail Sales Transactions, Second Quarter 2017

Building/Address	Market	SF	Delivery Year
Cedar Hills Crossing Community Center	North Beaverton	128,652	2018
The Dahlia	SE Outlying	56,800	2018
Restoration Hardware	NW Close-In	36,000	2017
24 Hour Fitness	Clackamas	38,000	2017

Source: CoStar and Kidder Mathews

Table 5: Notable Retail Sales Transactions, Second Quarter 2017

Building/ Address	Buyer	Market	Price	SF	Price/SF
Jantzen Beach Super Center	Kimco Realty Corporation	Hayden Island		747,000	$176.00
Division Center	Retail Opportunity Investments Corp.	Mall 205	$33,000,000	122,000	$270.00
Southgate Shopping Center	Kornwasser Realty Advisors	Clackamas	$11,650,000	50,862	$229.00

Source: CoStar and Kidder Mathews

SALES TRANSACTIONS

At the halfway point of the year, sales volume is expected to be slightly lower in 2017 when compared to last year's volume which topped $500 million in transactions. So far the bulk of transactions in 2017 have been from a smaller, but high priced group of sales. In the second quarter Kimco Realty Corporation purchased the 747,000 square feet Jantzen Beach Center for $131.8 million or $176 per square foot. This was the largest transaction of the quarter. Behind that was the sale of the 122,000 square feet Division Center which sold to Retail Opportunity Investment Corp. for $33 million or $270 a square foot. Kidder Mathews reports that the average price per square foot was $320 this quarter. The result of the increase in price per square foot came from single tenant properties occupied by recognized operators trading at below 6 percent cap rates. In the short term Portland has the right market fundamentals to continue to attract institutional investors looking for value when compared to other major West Coast markets.