RETAIL MARKET ANALYSIS

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In January of this year the payroll tax cut expired and retailers were apprehensive that this would further hinder the slow climb out of the Great Recession. But, during the second quarter of this year retail has begun to see spending near pre-recession levels. On the surface this is great news for retailers, but a closer look at the numbers and how they stack, reveals that there will continue to be a changing and challenging road for retailers and those who supply retail space.

Between 2005 and 2012, electronic sales of core retail goods reached 7%, a near doubling of sales during that time period. In particular, the electronic sale of books, music and video has seen the largest increases. In the year 2000, e-sales of these items stood at about 11.9%, by 2009 this number had dramatically increased to 54%. These goods are uniquely suited for e-commerce as there is no qualitative difference for an album or film bought in a physical or digital format.

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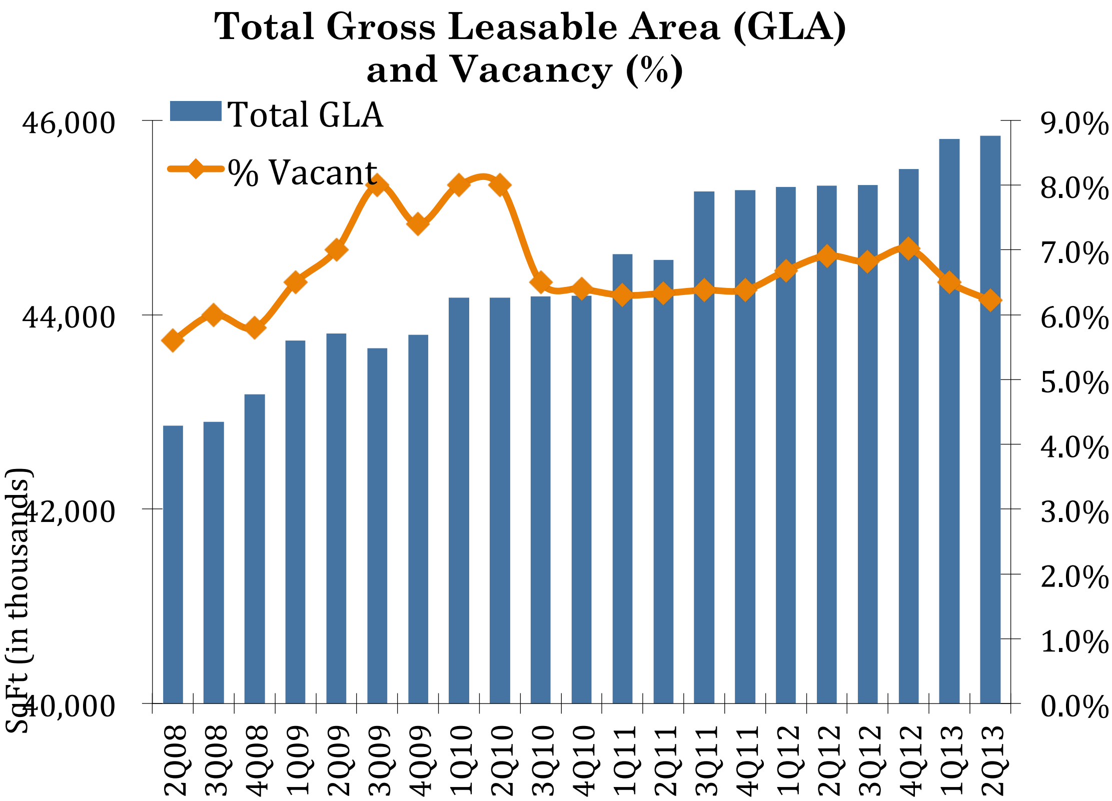
Share of Sector Activity	2000	2009
Books, periodicals, music and video	11.9%	53.5%
Clothing and clothing accessories (includes footwear)	1.3%	9.5%
Drugs, health aids and beauty aids	0.4%	2.4%
Electronics, appliances, computers and computer software	10.1%	28.8%
Food, beer and wine	0.1%	0.4%
Furniture and home furnishings	1.1%	11.4%
Office equipment and supplies	6.0%	28.3%
Sporting goods	1.6%	13.0%
Toys, hobby goods and games	4.7%	22.8%

Surprisingly, e-sales of appliances and computers has seen a dramatic increase during this same time period, rising from 10.1% to 28.8%. This is a second type of change that retailers are becoming familiar with. Customer are beginning to search online to highlight a few brands of stove or laptop, and then go to a brick and mortar store to turn nob, and return home to purchase the item at a discounted rate; turning Best Buys into showrooms for Amazon.com in the process. Target has taken on the strategy of in store price matching of products sold on Amazon to combat the show room effect.

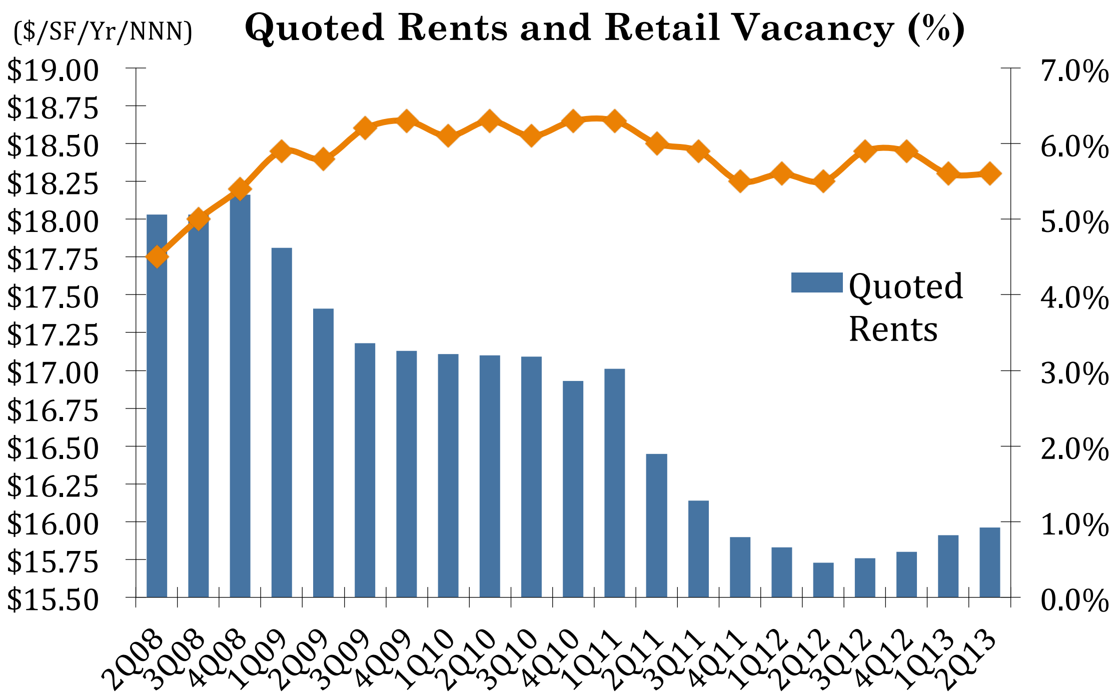
Though the retail market is experiencing a monumental shift in how consumers acquire retail items and that retailers like Barnes and Noble and Tower Records have thus far felt this change most bluntly, the market is still in the midst of the sea change. Currently e-commerce is experiencing 7.2% growth while brick and mortar retailers are experiencing an accumulated 3.8% growth (excluding automobiles). Keeping in mind that total retail volume, excluding automobiles, stands at $3.94 trillion and e-commerce holds 6.5% of this market; it will be quite some time until e-commerce could come to dominate even a quarter of the total market.

As the E-commerce and wealth distribution sea change winds its way through the national economy we see both similar signs of change and growth in the Portland MSA. Retail vacancy is holding strong at 5.5% (Norris & Stevens). Net absorption, though shrinking, remains positive at 85,625 SF (Norris & Stevens). Deliveries in the 2nd quarter are up at 33,949 SF (Norris & Stevens) with new construction currently at 141,793 SF (Norris & Stevens). Leading lease rates to rise to $15.96 per square foot (Kidder Matthews).



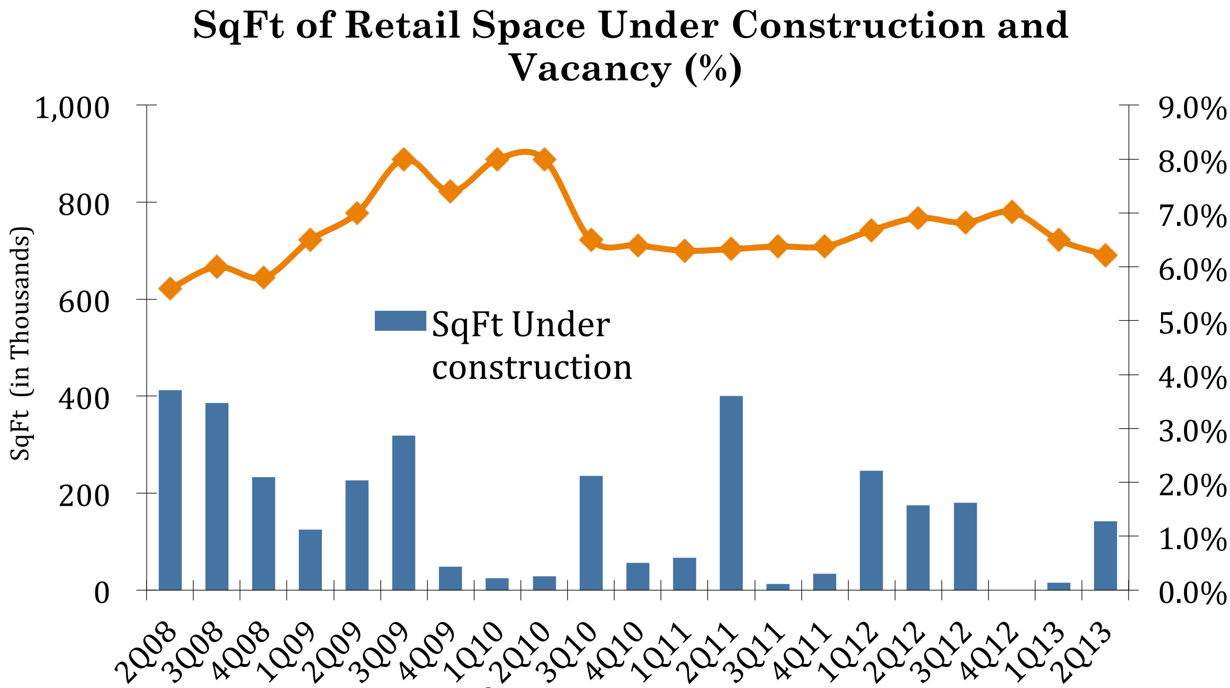
Source: Norris, Beggs, & Simpson Retail Reports

Norris, Beggs, and Simpsons are reporting the most bearish figures on the Portland MSA retail market with vacancy at 6.2% and absorption at less than 30,000 SF, vs. the more bullish reports of Norris & Stevens and Kidder Matthews with vacancy in the mid 5% range and absorption around 85,000 SF. In either case though, absorption is up and vacancy is down. During the 2nd quarter the market saw the departure of Kmart from two locations totaling 218,159 SF and the arrival of Orchard's Hardware to two locations. Despite the company's June filing of bankruptcy and selling off of California locations to Lowe's, Orchard's does plan to maintain the Portland area locations under their own brand and management.



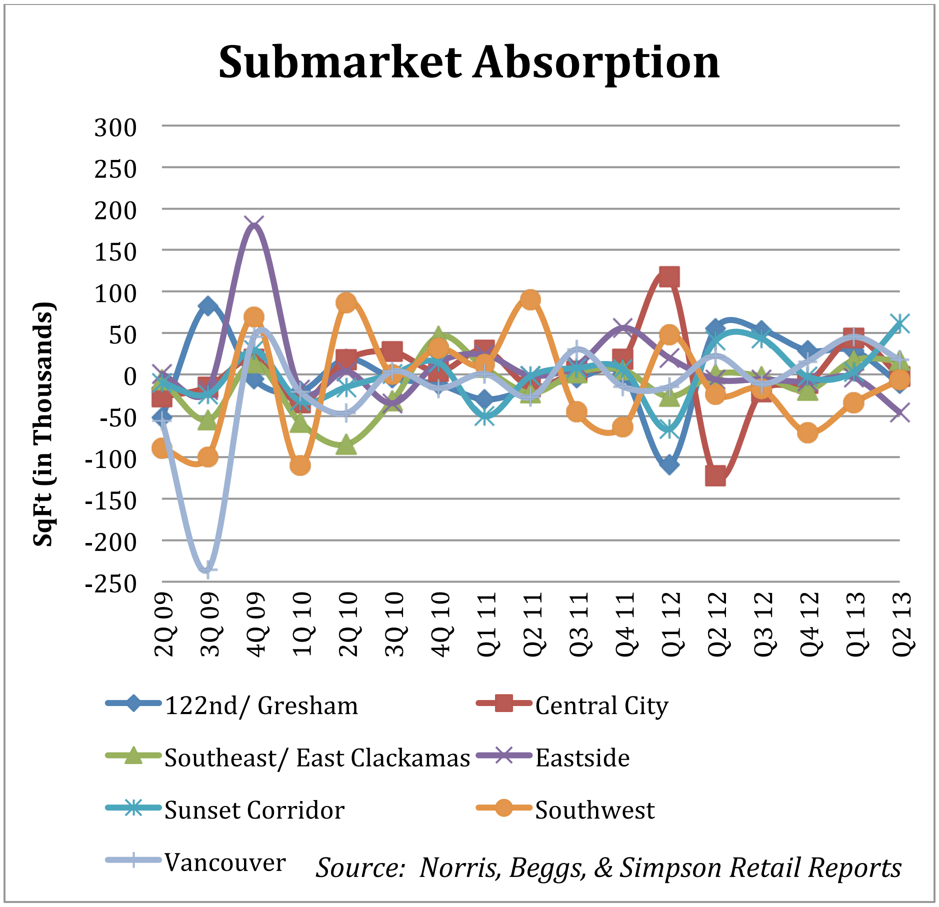
Source: Kidder Matthews Quarterly Reports

Kidder Matthews is reporting market area rent rates at $15.96/SF, which is in the ballpark of what both Norris & Stevens and CoStar are reporting of $16.06/SF. Reporting agencies are in agreement that rents are rising and vacancy continues to decrease. This is somewhat anomalous in regards to national trends as retailers work vigorously to adapt. Though the net affect in Portland may look like a reprieve, the continuing struggle between tenants' income stream and rent has sent many upstart restaurateurs packing as locals like Matchbox Lounge, Basa Basa, and Yaw's Top Notch have recently closed doors. Also, as available space stays relatively flat and rents rise landlords are beginning to pull back on offers of free rent and T.I. allowances. Of various shopping center types large neighborhood and community centers are maintaining a strong vacancy level of 9.6%, while unanchored strip centers are struggling with a vacancy level of 12.4% and slow absorption.



Source: Norris, Beggs, & Simpson Retail Reports

Over the past four quarters a total of 352,192 SF of new retail space has been added to Portland, with 33,949 SF added last quarter. Currently, 141,793 SF is under construction. In particular Kruse Village will bring 65,000 SF of shopping to Lake Oswego. This is being developed by Gramor, who will be busy developing a $30 million in the Cedar Mill neighborhood and $50 million retail center in Sherwood, as well as another development at 118th and Cornell that will break ground in August.



Norris, Beggs, and Simpson reports that 4 of the 7 major submarkets experienced negative absorption with the Eastside having the worst of it at negative 45,816 SF. The Southwest, though still in the negatives, continues to rebound. The Sunset corridor faired best last quarter with 61,223 SF.

The latest absorption is the new downtown Target. The new 89,000 SF Target in the old Galleria is a hallmark of the change in living patterns as more and more people move to urban centers. Target has brought 200 new jobs to the CBD and retail shopping until 10pm Mon-Fri. Also moving to downtown locations are Nike, Microsoft, H&M, and Sephora.

Source Kidder Matthews

Source: Kidder Matthews

Cap rates continue to remain relatively low as both vacancy and availability slowly decrease. The most noteworthy sale transaction in this last second quarter is the purchase of the remaining 40% interest in the Lloyd Center Mall by Cypress Real Estate Investment Management for $148 million.

Q2 2013 Sale Activity of Note

Property Name	Submarket	Size (SF)	Date	Sale Price	Price/SF
Yamhill Marketplace	CBD	77,000	Jun 2013	$4,500,000	$58.44
Lloyd Center Mall*	Lloyd District	1,475,728	Jun 2013	$148,000,000	$100.29
Tanasbourne Central	Sunset Corridor	46,083	May 2013	$12,400,000	$269.08
Retail Strip Center	Airport Way	6,250	May 2013	$4,000,000	$640.00

**Reflects 40% interest acquisition*

Source: Kidder Matthews

The Portland retail market continues to grow at an uneven and measured pace. Market forces regarding online shopping availability and wealth distribution have taxed retailers as they face the struggle between cash flow and rent levels while vacancy is down, absorption up, and construction flat. For large retailers who can learn to guide customers to their stores via an online presence, market share will grow. For small retailers who can bring value through experience and align themselves with large anchors, good things will continue to happen. ■