# The Lee Retail Brief

# Q1 2016



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COMMERCIAL REAL ESTATE SERVICES

**155%**
increase
in transaction volume over 5 years

**$12+ billion**
transaction volume
2015

**850**
agents
and growing

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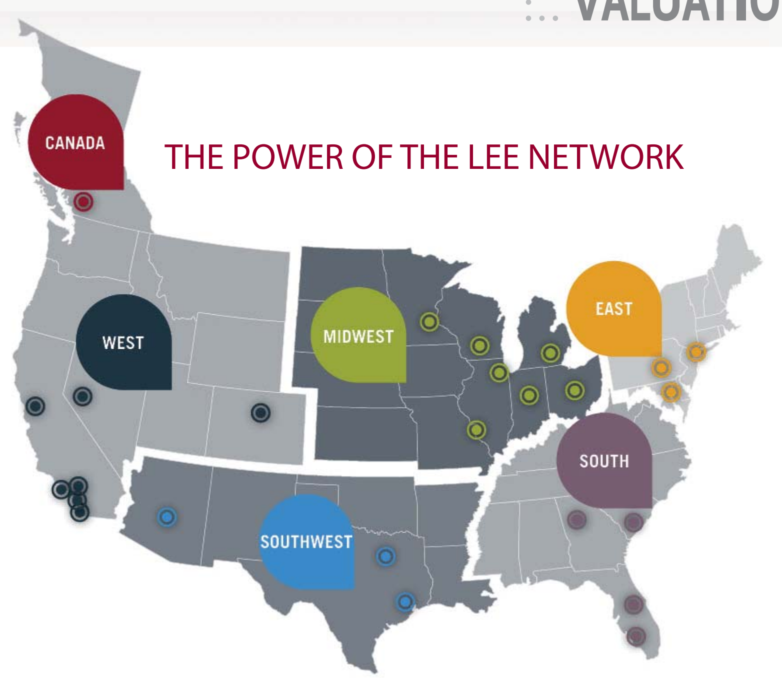
## THE POWER OF THE LEE NETWORK

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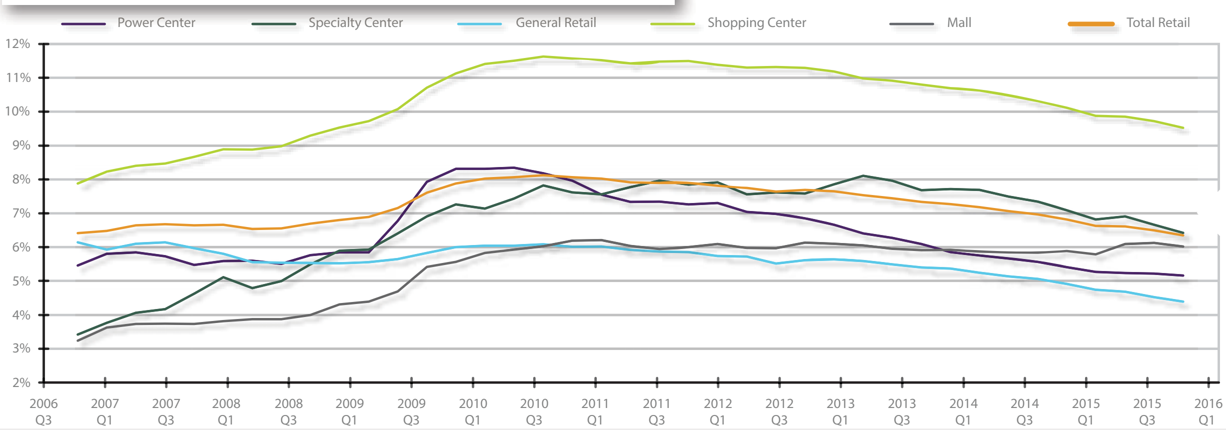
# PROPERTY MARKET TIGHTENS

## RETAIL SECTOR GROWTH EASES IN Q1

The US retail property market experienced tepid growth in Q1, but kept moving in the same direction. Net absorption, while positive, slowed during the first three months of the year, and the vacancy rate was unchanged after falling in the previous three periods. Average asking rents did rise, but only by .5% and new product deliveries were well below Q4's 25 million square feet total.

US retail sales declined by .3% in March, after a flat February and a .4% decline in January. Of the 13 major retail categories, automotive sales and parts dealers had the biggest impact, falling 2.1% in March. Even food services and drinking places, which

### VACANCY RATES BY BUILDING TYPE 2006-2015

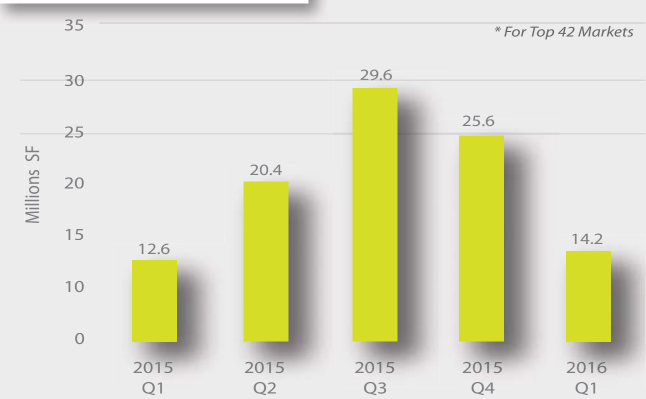



### ECONOMIC DRIVERS

- GROWTH
- EMPLOYMENT
- MONETARY POLICY
- GLOBAL ECONOMY

- A LOOK AHEAD

### NET ABSORPTION




had gains last year, posted a decline of .8%. Gasoline station's revenue reversed a long slide by gaining .9% on a rebound in gas prices. Furniture and home furnishings stores sales grew by .3% due to improving housing market conditions, while electronics and appliance stores improved by just .1% in March.

The vacancy rate ended where it started in Q1, holding steady at 5.6%. Since Q2 of 2015, only a 20-basis point decline in the vacancy rate has been realized. In many markets across the country, occupancy is sharply lower in secondary locations and nearing 100% in prime submarkets. General retail (freestanding, general purpose properties) posted the lowest vacancy of all retail property types at 3.7%, followed closely by Power Centers at 4.5%. Shopping Center (neighborhood, community and strip centers combined) rates were highest at 8.7%, which reflects the concentration of that product in the traditional suburban submarkets losing appeal to retailers.

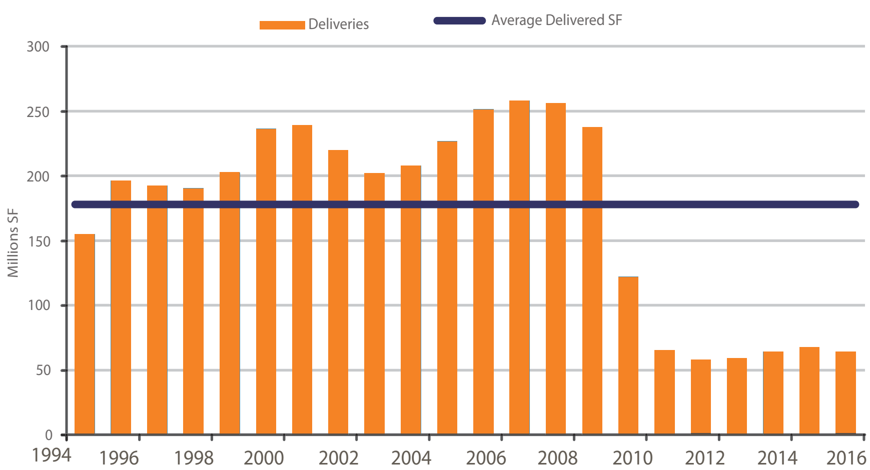
Urban areas continue to account for a greater share of net absorption as more retailers cater to the youth. They prefer to be close to public transportation, hip restaurants, cool bars and entertainment venues. With the millennials, it's all about the amenities, and not about cars and long commutes. Net absorption was positive, but sharply lower in Q1. The quarter finished with 18.6 million square feet of net gain, but that was 44% short of Q4's performance.

In the past four quarters, just under 110.5 million square feet of net absorption was recorded, a very impressive number given the facts that retail sales growth has been flat for several months and wage growth barely kept pace with 2015's nominal rate of inflation.

The overall average asking rate moved up another $.07 to $15.31 per square foot in Q1. For the year, retail rents across all product types and locations moved up by 1.5%, but a disproportionate share of rent growth was concentrated in prime locations, masking the weaker performance of suburban markets. In general, the rate of rent growth declines as distance from an urbanized core increases, as retailers follow the millennial revenue stream.

New deliveries for the quarter totaled 16.2 million square feet, bringing the total of completed inventory in the past four quarters to 83 million square feet. Another 70.2 million square feet is currently under construction. Urban locales are seeing the bulk of new construction. Retailers will pay more for those locations because that's where the millennial population is growing fastest. Traditional, brick and mortar and online retailers continue to move toward one another in terms of strategy. Just as major online retailers are adding physical locations, traditional retailers are boosting their online presence and closing down underperforming physical locations. After Macy's and Walmart announced major store closings late last year, Sears recently followed suit by deciding to close 79 underperforming K Mart and Sears stores from coast to coast. Two big sporting goods retailers also took drastic action. Sport Chalet decided to close all its stores and Sports Authority filed for bankruptcy in early April. Growth in online sales poses a serious threat to traditional retailers, and these recent store closings make clear the consequences of a failure to respond proactively.

HISTORICAL DELIVERIES 1982-2015




## A LOOK AHEAD

The US retail market will keep growing, but at a more tepid pace over the next several quarters. Weak GDP and wage growth numbers will put downward pressure on retail sales volume. Imported goods will remain cheap due to the strength of the US dollar, and that will keep the discount retailers busy expanding. In the last 12 months, the prices of import goods have fallen by 6.2%. A recent increase in oil prices have propped up overall import prices, but that only masks the continuing decline in the price of other imported goods. Look for further declines in the price of foreign goods going forward due to further currency declines designed to prop up sagging economies around the world.

Low oil prices have been with us for close to two years, but the boost in retail sales that was expected as a result of an increase in disposable income, has been weak. Job losses, especially in the energy sector, are ongoing and retail sales numbers are bound to be impacted going forward. Moreover, a high percentage of the new jobs created in other sectors are lower-paying, part-time or both. Without higher wages, it's hard to see retail sales making any significant gains in 2016.

Vacancy rates and net absorption will remain near current levels for the balance of 2016. Prime submarkets in major metro areas will struggle with low supply. Oversupply of capital to invest will keep yields on retail investment properties compressed. Domestic institutions will focus more on retail assets in 2016, as supply is running even shorter for industrial and office assets. Foreign investors will add additional pressure on supply, as they look to find a safe place to stash capital and minimize exposure to global economic turmoil.

# GDP GROWTH

GDP, the key measurement of the total output of US goods and services continued to run at a slow pace in the first quarter of 2016. The first estimate of Q1 GDP growth, according to the GDP Now index, is a dismal .3%. Persistent concerns over political and economic issues around the world are keeping optimism here at home in check. The year started with a big selloff in the US equities markets. Fortunately, most of those losses were recovered during Q1. Three weeks into Q2 2016 the Dow was back above 18,000 and the S&P recovered most of its losses, despite a disappointing earnings season. Volatility in equities has become commonplace as jittery investors react quickly to anything and everything. GDP performance hasn't helped to ease those concerns. The final estimate of GDP for Q4 indicated just 1.4% growth, which didn't help change the economic narrative. The US economy grew by only 2.4% in 2015, and the poor Q1 number makes it unlikely that 2016's growth trajectory will improve.

QUARTER-TO-QUARTER GROWTH IN REAL GDP


Consumer spending, which accounts for roughly 70% of GDP, is the main culprit. US consumers are keeping a firm grip on their wallets, as their outlook for better times remains hazy. Retail sales, a large component of consumer spending, declined by .4% in January, was unchanged in February and fell by .3% in March. Persistently weak wage growth may be partly to blame. Income growth is running close to the rate of inflation, which is still under the Fed's target of 2%. So, workers are just don't feel like they are getting ahead, and that makes them more cautious about making the big purchases that will give consumer spending the shot in the arm it needs. Instead, they continue to pay down existing debt to reduce their exposure to financial troubles down the road.

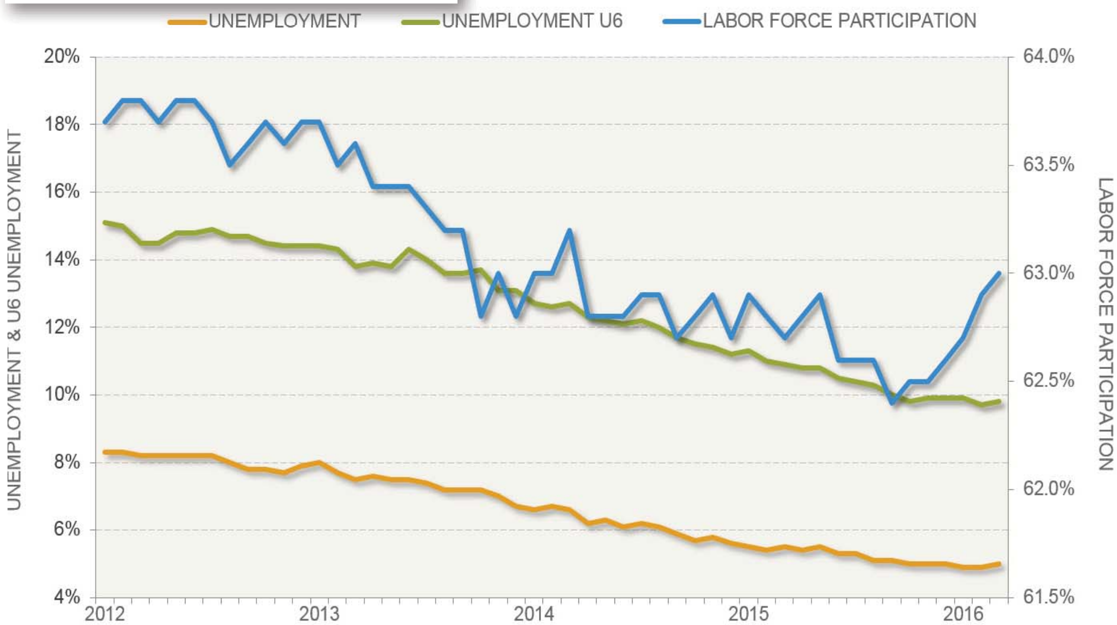
Net exports, another key component of the GDP equation, have been hurt by the US dollar's strength against other currencies. US goods and services are getting more expensive abroad and the impact to US companies is measurable. In Q1, that impact was slightly abated, as the dollar did lose some ground against other major currencies after the Fed signaled a slowdown in the frequency of interest rate adjustments. Though, significant currency fluctuations are likely to remain a persistent thorn in the side of export growth, as economies around the world continue to play the devaluation game to make their goods and services more attractive.

# EMPLOYMENT

Job growth picked up in Q1 after showing signs of slowdown in the latter half of 2015. By the close of Q1, the unemployment rate stood at 5%, up 10 basis points since February. Job gains for the quarter were strongest in retail trade, construction and healthcare. Hiring in the manufacturing remained in a funk, a direct result of a decrease in manufacturing activity. The key manufacturing index compiled by the Institute of Supply Management (ISM) has spent most of the past year in negative territory.

The high proportion of part time positions may give the numbers a boost, but they aren't doing much in terms of helping the middle class get ahead. Over 6 million workers who prefer to work full time are still stuck in part time jobs. The U6 unemployment rate, which includes roughly 6 million of such workers, ended March at 9.8%, up 10 basis points from the previous month. Concerns over slowing domestic growth and the prospect of recessions abroad is prompting employers to hire part time and temporary workers. The cost of health care pursuant to the Affordable Care Act (ACA) is also contributing to part time employment problem, as employers are inclined to hire workers just under the 30 hour per week threshold that would require them to provide health benefits.

NATIONAL UNEMPLOY-



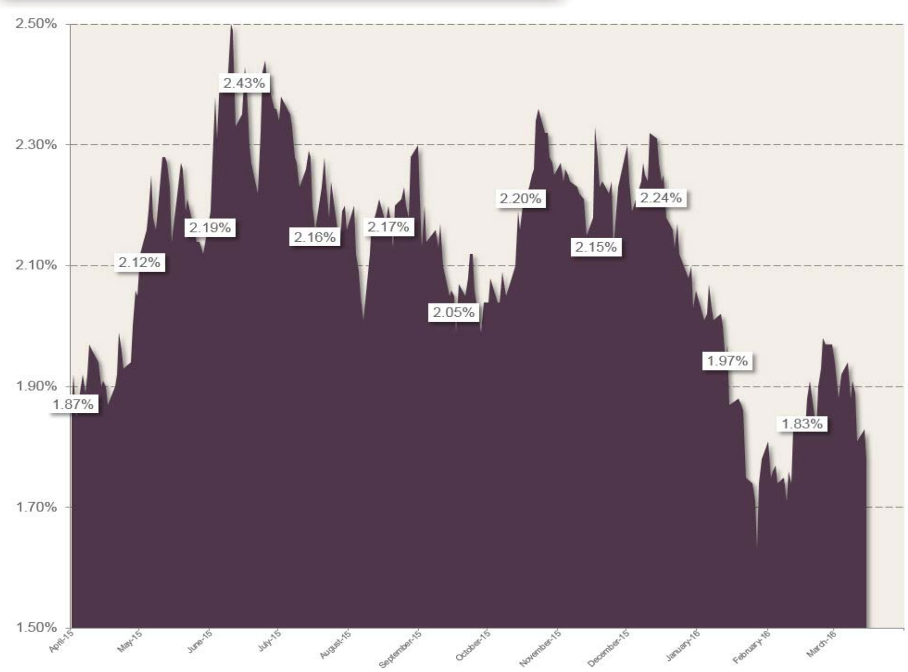

The Labor Participation Rate, the metric that measures the percentage of those eligible for employment between the ages of 16 and 64 who are currently working is also stagnant. Sporadic job growth and the early exit of Baby Boomers, who are retiring at a rate of 10,000 per day, have combined to keep just 63% of potential workers in active production.

Wage growth is another problem that has dogged the US economy since it began recovering back in 2010. While the general unemployment rate has fallen to 5.0%, full-time, high-paying jobs are in short supply. And, many of those positions sit unfilled due to a lack of qualified candidates. Without a good boost in wages, consumer spending, the main GDP driver, will remain stagnant. Layoffs in the energy sector has not helped the job picture, either. Thousands of high wage positions are disappearing and it may be years before the energy sector recovers enough to see those jobs return. The jobs being lost are generally full-time, and that only makes things worse. The oil industry continued its belt tightening in Q1 idling more wells and slashing capital expenditure budgets. So, further job losses are expected.

# MONETARY POLICY

Fed Chairperson, Janet Yellen and her Board of Governors have tamed down the rhetoric regarding multiple rate hikes in 2016. Back in December, when they finally pulled the trigger on an initial rate hike, it had little immediate effect here at home. But, it did push up sovereign bond yields on dollar-based sovereign debt. Needless to say, central bankers around the world expressed their displeasure with the move and have since been warning the Fed that further rate hikes in the short term will be harmful to the global economy. The Fed's move ran counter to the actions of other central banks that have been engaged in aggressive quantitative easing and lowering benchmark rates into negative territory. The Fed's action reduced uncertainty about the policy direction in the beginning, but now Ms. Yellen is singing a more cautious tune. So, decision makers everywhere look to be heading back into the fog when it comes to predicting the cost of capital going forward.

TEN YEAR US TREASURY YIELD
IN PERCENTAGE




Real estate borrowers have been relieved to discover that the Fed's initial rate hike had little effect on mortgage interest rates. Long term financing is still cheap and demand to acquire commercial real estate has been unaffected, thus far. Cap rates remain compressed with no clear sign of a change in direction, but there is a lot more talk about that now than there was a few months ago. If the Fed follows through with more rate hikes soon, the possibility of higher cap rates will become very real indeed. Even a 50 basis point move up would have a massive impact on property values. Rents, even in the fastest growing markets are not climbing nearly fast enough to bridge that gap.

The yield on 10-Year Treasuries moved back down late in the year, then up again before settling at around 1.85% by the end of the quarter. Many attribute the downward pressure on yields to a "flight to quality", as foreign capital pours into T-bills as a safe haven. If that is true, then real estate borrowers will benefit directly, as most commercial real estate mortgage rates are based on a spread over the 10-Year.

# THE GLOBAL ECONOMY

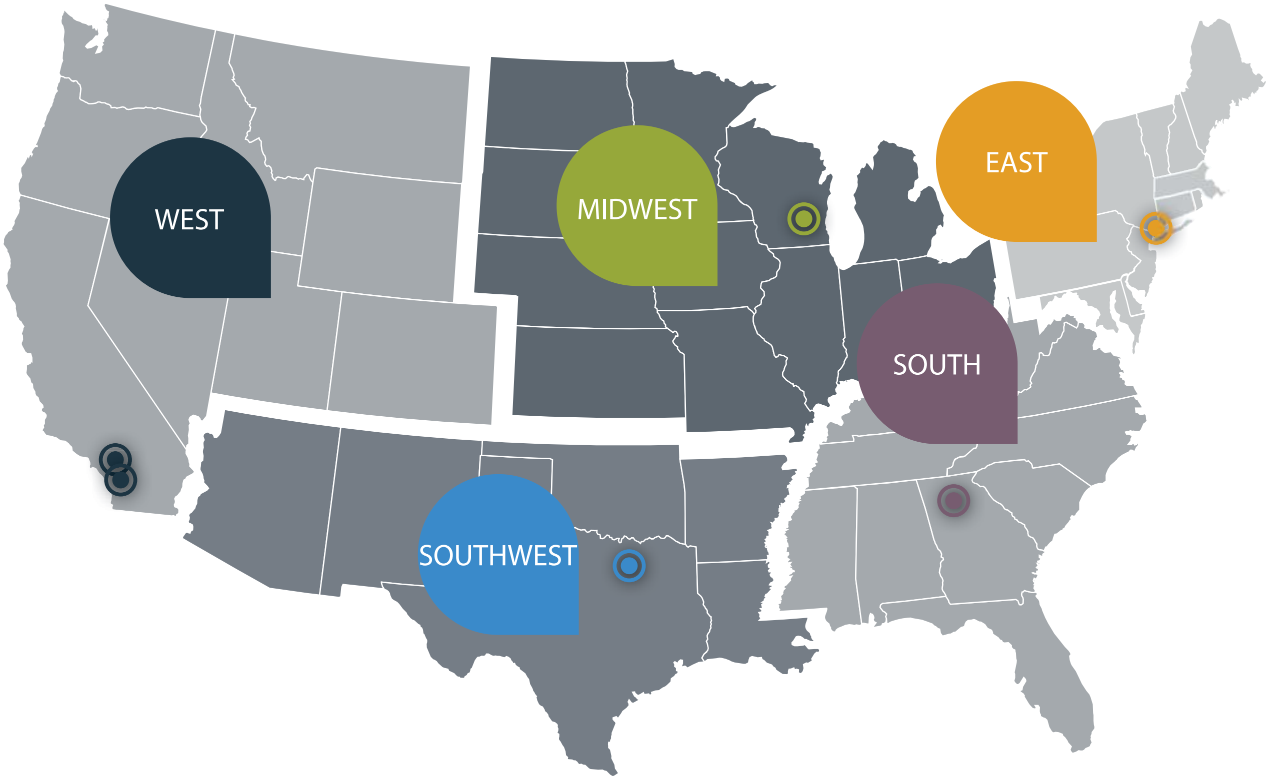
The global economic outlook continues to look troublesome. Whether the topic is the European Union, emerging markets, energy-producing states or the manufacturers of the world's goods, the news is mostly bad. Global growth estimates keep moving down and several countries are in recession, especially countries like Brazil and Venezuela that depend almost entirely on the export of raw materials and oil. Europe's political union goes from one crisis to the next it seems. Without having the authority to enforce fiscal activity, EU leaders and European Central Bank have been ineffective in addressing skyrocketing debt around the system. Calls for austerity from nations swimming in debt been largely ignored, and the recent refugee crisis is exacerbating economic problems in Southern Europe where the flow of refugees from the Middle East is heaviest. Border enforcement issues are resurfacing as a result of the staggering cost of providing hundreds of thousands of displaced citizens, mainly from Syria.

EURO AREA REAL GDP[2]
(QUARTER-ON-QUARTER PERCENTAGE CHANGES)


Oil-rich Middle-Eastern countries, including Saudi Arabia, are issuing sovereign debt and burning through cash reserves to cover revenue shortfalls precipitated by the falling price of oil. Even China is issuing sovereign bonds to help it cope with its massive transition from total dependence on the exportation of manufactured goods to a more consumer-based economy that can be self- supporting. Gone are the days of double-digit economic growth in the world's most populous country.

Despite all these concerns, the US economy is still growing, but just above stall speed, a fact not lost on major corporations that are already facing a slowdown in profit growth. Many of the nation's biggest companies are boosting share prices by buying back their own stock and slashing costs, rather than by increasing revenues. Even commercial real estate markets continue to grow at a steady and healthy pace. Rents are rising, vacancy is declining and new buildings are being delivered at a pace that limits the potential of overbuilding. Employment is on the rise, but wage growth is weak. Inflation, once considered evil, is the hoped for outcome of central bank policy. Yet, even with all its efforts to boost inflation, it is still running well below the desired level of 2%. Without rising prices, there is little incentive to increase production by hiring new workers. We don't see things changing much to the good as we look ahead. So, we expect another year of modest economic growth and improving market metrics for industrial real estate. All things considered, things could be a lot worse.

# Key Market Snapshots




To view a key market snapshot either click on a section of the interactive map above or on the cities below.

ORANGE COUNTY
SAN DIEGO NORTH

DALLAS

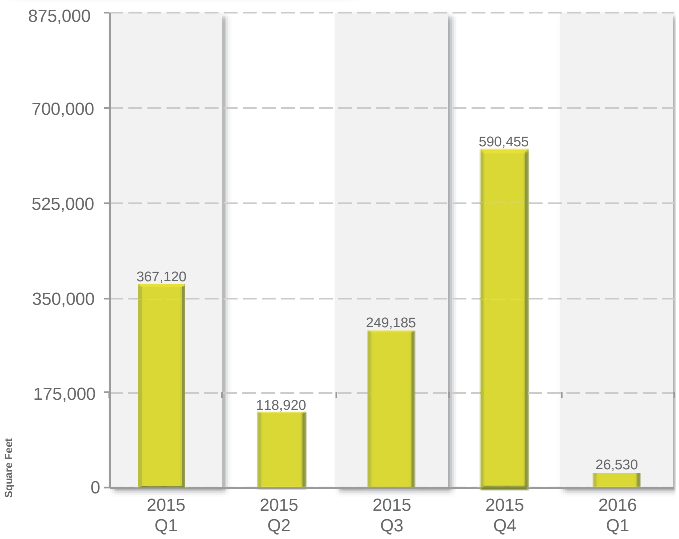
INDIANAPOLIS

ATLANTA

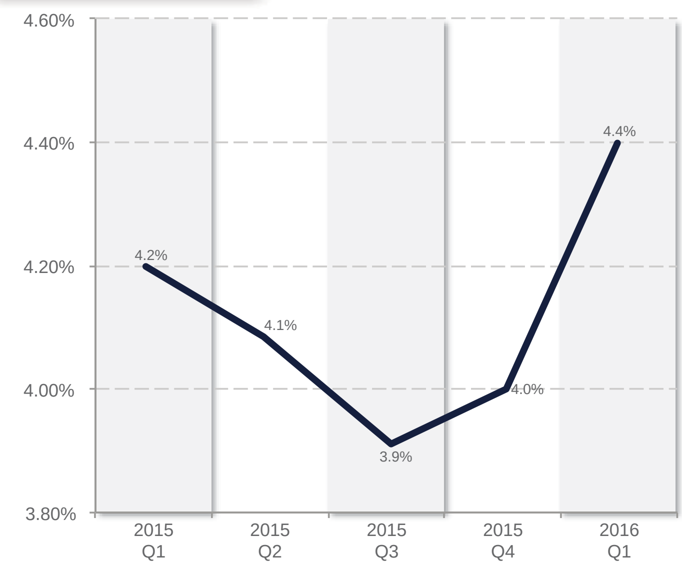
MANHATTAN

# ORANGE COUNTY

## NET SF ABSORPTION




## VACANCY RATE




## TRENDING NOW

The economic growth rate of Orange County outpaces most of California. The OC is on course to create another 42,000 new jobs in 2016, adding to the 47,000 positions added last year. Many of those jobs are full time and in higher-paying tech, business services and health services sectors. The unemployment rate finished Q1 at 4%, well ahead of the national rate of 5.1% and the 5.6% rate for California. Housing prices moved up by another 8.7% over the last 12 months, and despite an ongoing shortage of inventory, the number of homes sold managed to increase by 7.4% in the same period. These steady gains show up in the retail sales statistics that drive expansion in the retail sector.

Vacancy drifted up in Q1, increasing by 40 basis points in the period, after a 10 basis point rise in Q4 of last year. Though, the vacancy picture is really a split screen. Most of the empty space is found in secondary locations and mid-block strip centers. The occupancy picture in prime locations, especially in coastal submarkets, looks quite different. Occupancy in these areas is nearing 100%. Local retailers, typically found in B and C centers, are struggling to compete with the bigger players. However, the average asking lease rate still managed a $.09 gain in Q1 to finish at $25.29. Year-over-year, the increase in asking rents topped 6%. What does remain to be seen is the effect of Sport Chalet's recent decision to close all of its stores and the bankruptcy of another sports retailer, Sports Authority.

Net absorption for Q1 stayed in positive territory, but not by much. The net gain was a disappointing 26,530 square feet after posting a rise of 590,000 square feet in Q4. The steep drop-off may be more a case of not enough space

| 4.4% | $25.29 | 26,530 | 143,193,227 | 123,075 |
|---|---|---|---|---|
| VACANCY | AVG. SF RENTAL RATES | NET SF ABSORPTION | RETAIL SF INVENTORY | SF UNDER CONSTRUCTION |
| ▲ | ▲ | ▼ | ▲ | ▼ |

## ORANGE COUNTY - TRENDING NOW
(continued)

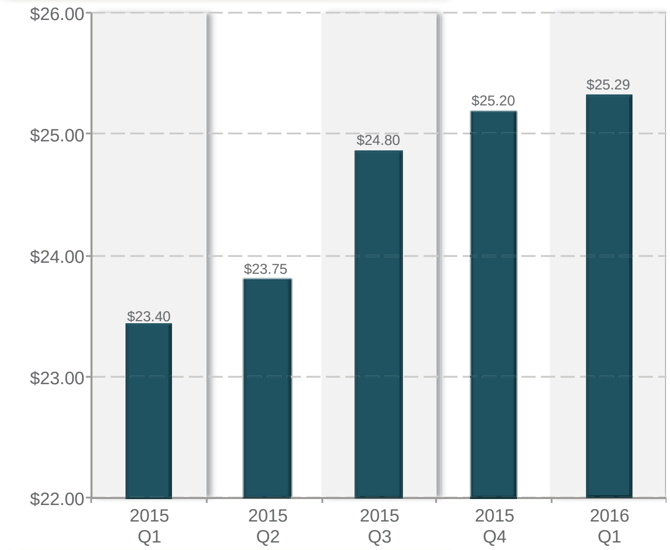
in prime areas rather than a lack of overall demand. Restaurant operators are still competing for space in well-located centers, boosting rental rates in the process.

Grocery stores of all kinds continue to expand. After recently opening a new store in Tustin in Q4, Smart & Final inked a 38,068-square-foot lease on Plano Trabuco Rd in Trabuco Canyon. Trader Joe's will move its Tustin store to a former Long's Drug space in the Tustin Heights Shopping Center. Petco recently opened in the same center, and PetSmart announced a new location on Aliso Creek Road. Crunch Fitness stayed in expansion mode by signing a 25,870-square-foot lease at 18081 Magnolia St. in Fountain Valley.

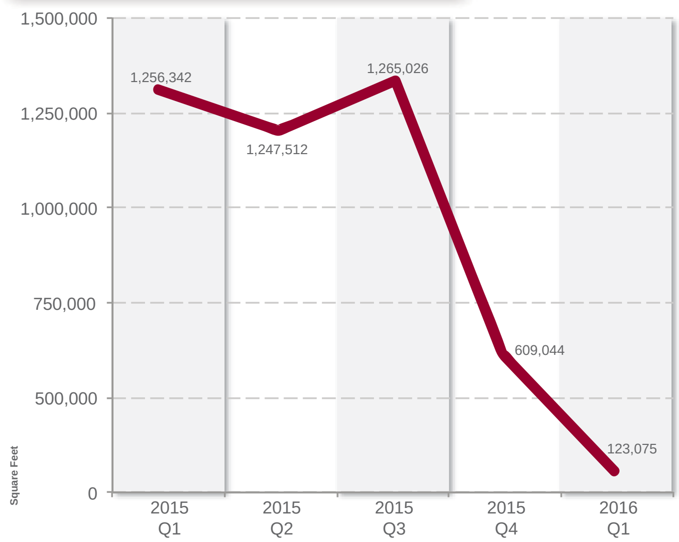
Cap rates have compressed to record lows, as investors look more to retail for higher yields compared to other commercial property types. Existing owners, fearful of a cap rate decompression that would accompany an expected rise in mortgage rates, are pushing hard on rents and reducing concessions to boost to net income as an offset to higher cap rates down the road. However, rent growth would have to be stronger than expected to cover even a 50-basis point cap rate shift to the upside.

Demand for single-tenant-net-lease properties has never been higher. They are especially popular as up-legs to 1031 exchanges, as many investors are looking for less management intensive assets with stabilized cash flows. Owner/users are obliging by selling off locations and leasing them back for up to 20 years. They see it as a good way to access capital for further expansion.

AVERAGE SF RENTAL RATES




SF UNDER CONSTRUCTION

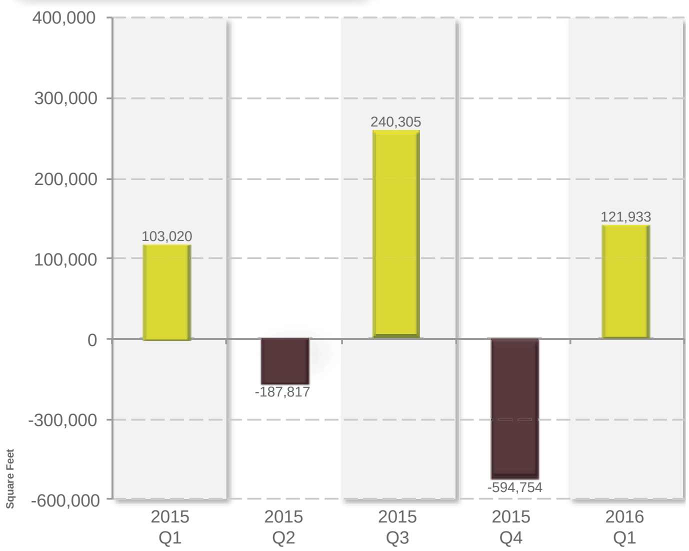



## A LOOK AHEAD

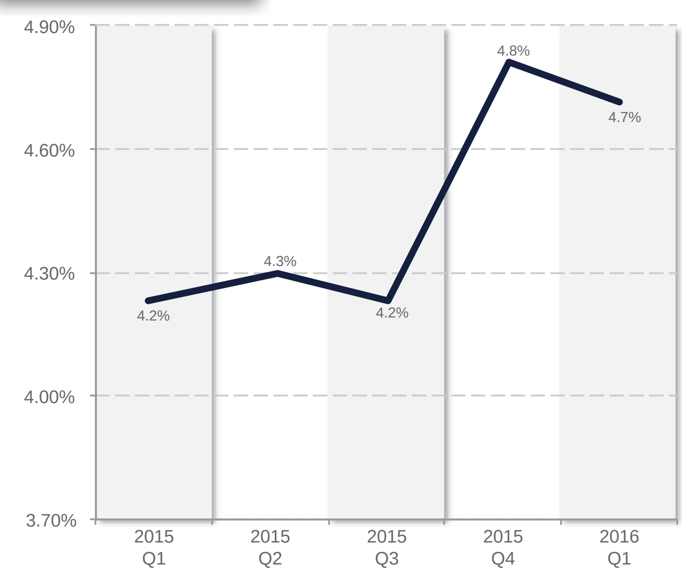
- Supply of good quality product will become more problematic as the year progresses
- Overall vacancy for the county will remain in the 4% range for the rest of the year
- Net absorption will be restricted by a shortage of prime space
- Overall lease rates will remain flat in 2016, but prime space will see increases of 5% or more
- Good job growth will keep stronger retailers expanding
- Construction activity will be nominal for the balance of the year

# SAN DIEGO NORTH

## NET SF ABSORPTION




## VACANCY RATE




## TRENDING NOW

The San Diego retail market remains bifurcated. Vacancy is much higher in Class B and C product, while most of the tenant interest is focused on the highest quality locations where prices are highest. National and regional chain retailers are competing for quality space and remain willing to pay a premium to get it. Overall average asking lease rates have been moving erratically since 2014, falling substantially in Q3 of last year after steady gains. But in Q1 of this year, most of that decline was erased, as the rate moved back up to $22.41, a gain of $.56. However, that still represents a year-over-year decline of $.29.

So it comes down to a case of the haves and have-nots, whereby prime locations are experiencing strong rent growth, while secondary suburban centers struggle, many of which are going through a transition caused by the strategic retreats of grocery operators Albertson's and Haagen's. Most of the empty anchor stores are getting snapped up by other grocery chains, discount stores and fitness clubs, but other tenants remain uncertain how the transition will affect customer traffic. Landlords of these properties are willing to offer lower lease rates and additional concessions to interested tenants.

Net absorption for Q1 bounced back into positive territory, posting a gain in occupied space of 121,933 square feet, after a negative 594,754-square-foot in the final quarter of 2015. North County had negative absorption of 8,476 square feet, its second consecutive quarter of minor occupancy losses, but the area has made a remarkable comeback after overbuilding exacerbated the effects of the last recession.

| 4.7% | $22.41 | 121,933 | 134,789,257 | 401,929 |
|---|---|---|---|---|
| VACANCY | AVG. SF RENTAL RATES | NET SF ABSORPTION | RETAIL SF INVENTORY | SF UNDER CONSTRUCTION |

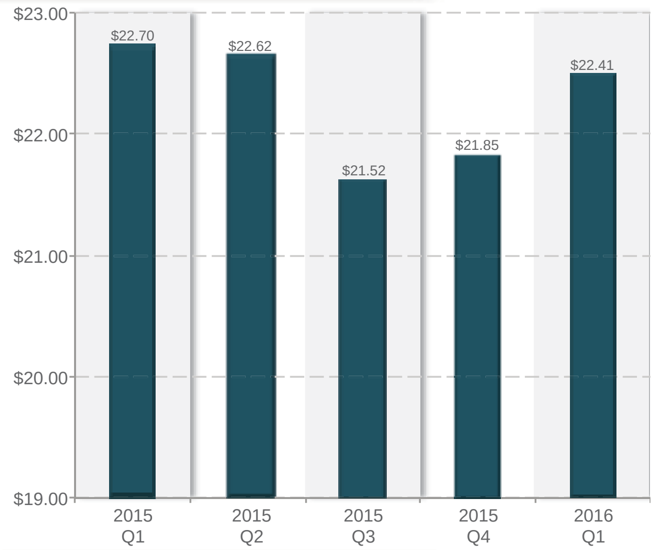
## SAN DIEGO NORTH - TRENDING NOW
(continued)

The overall vacancy rate in Q1 dipped 10 basis points, to 4.7%, but that rate is up 40 basis points in the past four quarters. North County still posted the highest rate at 6.2%. Central County's vacancy of 3.6% is still lowest in the region. With construction holding steady at very low levels, occupancy levels should increase, which should benefit owners of centers in secondary locations. Strip centers in suburban locales have stabilized, but rent growth is flat and landlords are offering concessions for good credit.

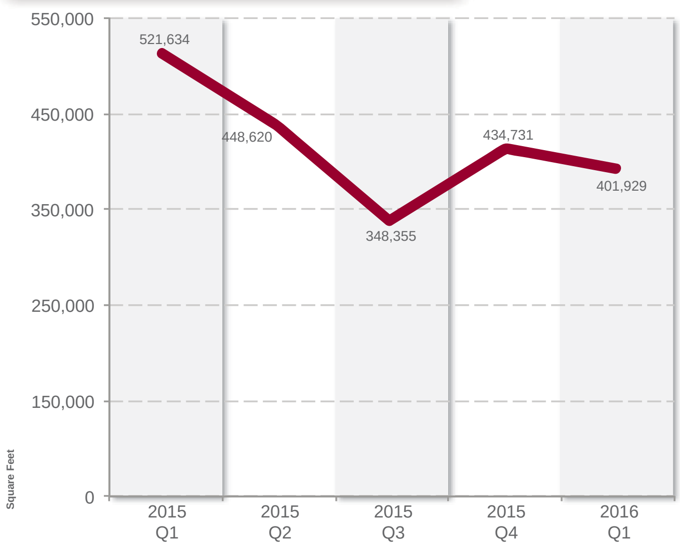
Construction is mostly limited to the remodeling, expansion and repositioning of existing retail projects. As reported last quarter, Westfield has two projects underway including the ongoing expansion of its UTC regional mall and the transformation of Plaza Camino Real from an indoor to open-air center. Palma De La Reina, a mixed-use retail/office/residential project is underway in upscale Rancho Santa Fe. This new center will capture premium rents from trendy retailers looking to locate near customers with more disposable income. In all, 402,000 square feet of retail space is currently under construction.

The largest leases signed in Q1 were both grocery deals. The first, a 32,400-square-foot lease to Smart & Final, located at 40 N 4th Ave and the other a 14,920-square-foot lease to Island Pacific Supermarket at Paseo Corners.

AVERAGE SF RENTAL RATES




SF UNDER CONSTRUCTION

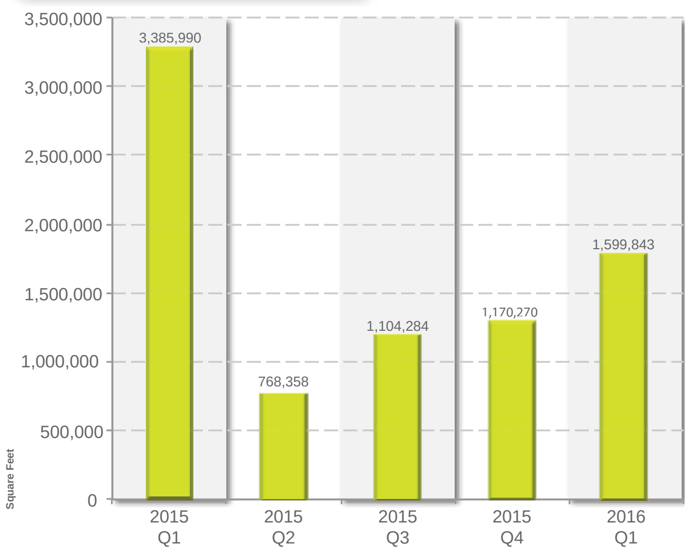



## A LOOK AHEAD

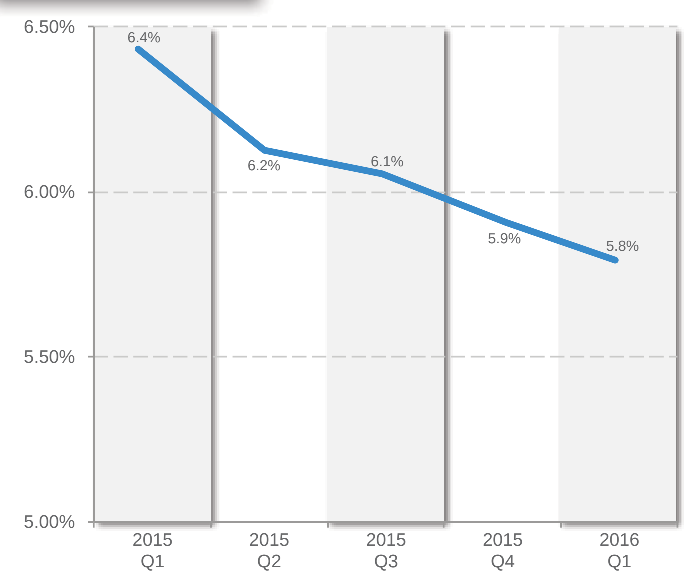
- Net absorption should remain at current levels, as new retailers step in to lease closed anchor locations
- Vacancy will decline slightly throughout the year
- Average asking rental rates will move back up 3%-5% over the next four quarters
- Construction activity will remain confined to redevelopment and expansion of existing centers
- Continued improvement in the San Diego economy will keep retailers expanding, especially in prime locations near high density residential developments

# DALLAS / FORT WORTH

## NET SF ABSORPTION




## VACANCY RATE




## TRENDING NOW

Layoffs in Texas' energy towns have been dominating the headlines these days. Big oil has been slashing capital expense budgets and laying off thousands of workers. But the Dallas/Fort Worth region is not dependent on the oil industry like Houston is. DFW is better known as one of the most active distribution hubs in the US and a place for big corporations to look to for long term expansion. State and local government agencies continue to offer significant tax incentives to relocate to the Dallas area, and that has given the region a reputation for being business friendly. Increases in employment and overall population have boosted retail spending and prompted retailers to keep growing to meet consumer demand.

Retail vacancy continued its decline again in Q1, falling by 10 basis points to 5.8%.Year-over-year, vacancy fell by 60 basis points. Correspondingly, net absorption has been consistently positive. In 2015, a net gain of 8.1 million square feet was realized, with big retailers like Target and Walmart as major contributors. In the first quarter, the total of occupied space rose by another 1.6 million square feet.

Average asking lease rates including all retail categories for the quarter moved up $.15 to $15.02. Year-over-year, that rate is up by 6.3%. Rents are moving up even faster for the best locations forcing some tenants into secondary locations to mitigate higher occupancy costs. Power Centers have the highest asking rates at $33.04. Regional mall asking rents ending Q1 at $20.76, up $1.52 in the past four quarters.

By center type, it's the mixed-use projects in the suburbs and in Uptown (near the CBD) that are doing very well. Nearby residents and office workers continue to flock

| 5.8% | $15.02 | 1,599,843 | 407,051,361 | 3,973,893 |
|---|---|---|---|---|
| VACANCY | AVG. SF RENTAL RATES | NET SF ABSORPTION | RETAIL SF INVENTORY | SF UNDER CONSTRUCTION |

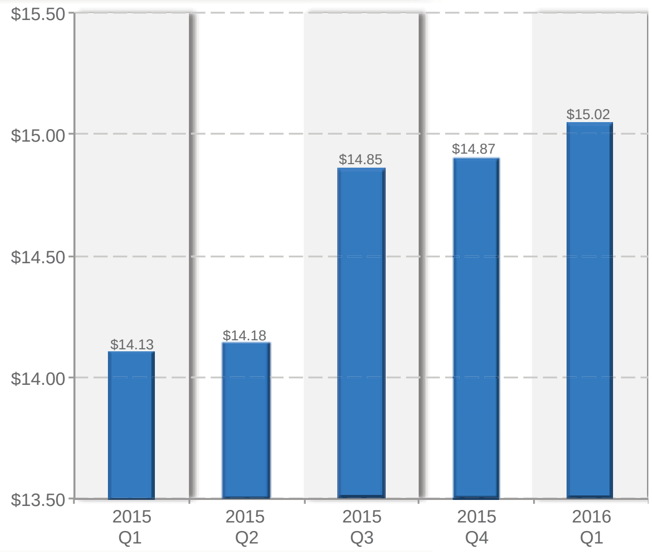
## DALLAS / FORT WORTH - TRENDING NOW (continued)

to these newer developments for dining and shopping. These centers tend to have much lower vacancy and asking rental rates have risen to a record high of $32.46 per square foot. Just a year ago, rents in mixed use projects were averaging just $21 per square foot. Suburban strip centers are also performing well throughout the region, and after a lull in construction activity in 2015 (just 238,000 square feet completed), deliveries for strip centers are back on the rise. Over 100,000 square feet has already been completed and another 350,000 square feet was underway at the end of Q1.

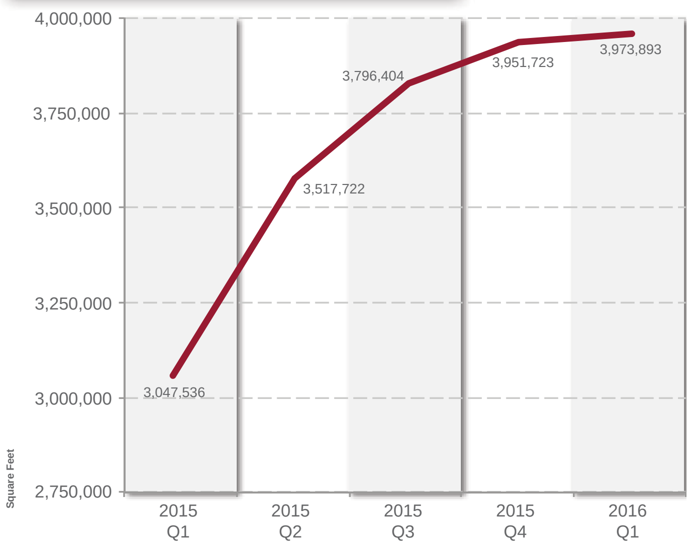
New deliveries for the entire region in Q1 included 70 buildings totaling 1,153,098 square feet. In 2015, over 6.2 million square feet of retail space was delivered in 218 buildings. Construction activity has been steady since 2013, averaging nearly 5 million square feet per year. In Q1 of 2016, close to 4 million square feet was underway. While fears of overbuilding have not yet surfaced, developers are keeping a watchful eye on oil prices and global events that could stall the national economy and trigger a pullback in retail spending. Retail sales growth has already been struggling at the national level.

Investment activity slowed in the first quarter, as just $92 million in retail properties traded hands. In 2015, over $1.5 billion in retail sales were closed. Some investors are becoming wary of the cap rate compression that has been ongoing, which may account for the quarterly lull in activity. Still, overall investor demand continues to run ahead of supply, mirroring a national trend.

### AVERAGE SF RENTAL RATES




### SF UNDER CONSTRUCTION

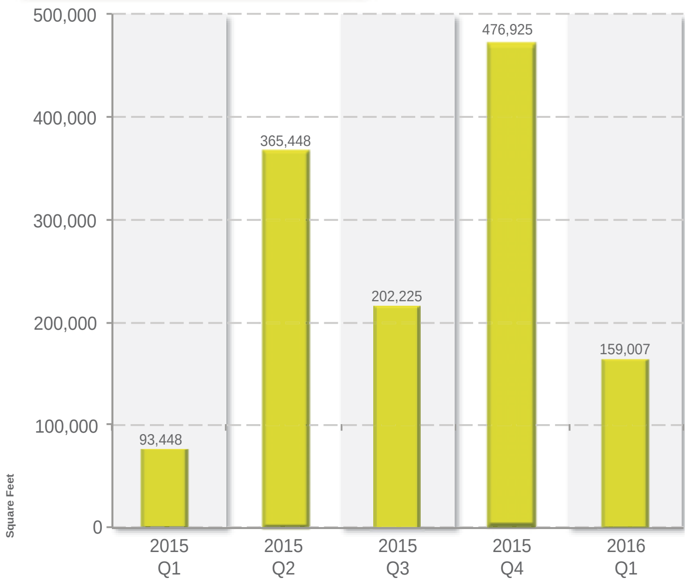



### A LOOK AHEAD

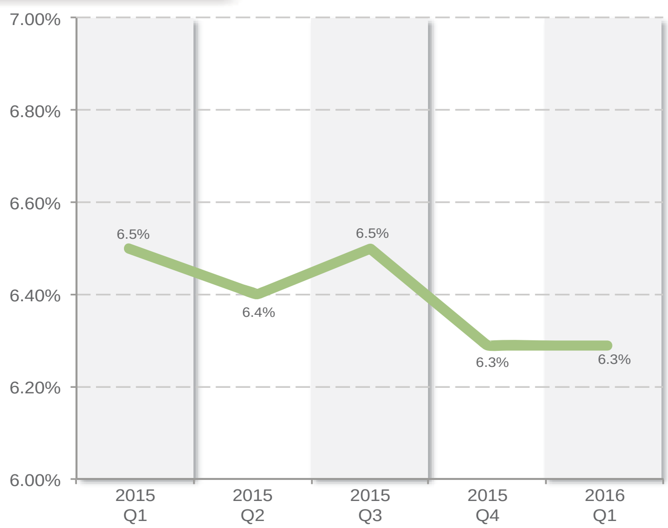
- Gross sale and lease activity should increase further in 2016
- The energy sector slowdown will have little impact on retail activity in 2015
- Net absorption should remain strong
- Vacancy, already at historic lows, will continue to decline
- Average asking lease rates will keep moving higher
- Construction will stay near current levels as developers will be cautious not to overbuild

# INDIANAPOLIS

## NET SF ABSORPTION




## VACANCY RATE




## TRENDING NOW

The Indianapolis retail sector continues to improve overall. Increasing employment in the tech sector is fueling office, retail and residential development. Leasing activity remains strong across the region, especially in the Fishers, Indiana submarket. Multi-family development downtown continues to attract retailers and restaurant operators, anxious to tap rising demand from millennials, who prefer the convenience of an urban lifestyle. In the 12-month period ending in February, the unemployment rate fell 80 basis points to a scant 4.9%. Over 25,000 new jobs were created and the area workforce expanded by 2.5%. Education and health services accounted for 6,200 of the new positions.

The vacancy rate was unchanged in Q1, holding at 6.3%, but is down 20 basis points since the end of the first quarter of last year. However, the increase in activity for preferred locations has tenants competing for space, which has sent the message to landlords that there is still plenty of room for rent growth. The average asking rental rate has moved up $.24 to $12.40 per square foot in the past year, but fell by $.13 in Q1 after three consecutive quarterly increases. However, the average rate is doesn't reflect the fact that rents have moved much higher for quality space in prime submarkets.

The grocery chains and national discounters are still among most active retailers in the Indianapolis area. However, other major chain retailers are also stepping up activity, including those in pet supply, fitness and financial services. In the first quarter, major lease signings included the 27,400-square-foot lease to Ross, an 18,000-square-foot lease to Party City at 8707 Hardegan St. and a 9,100-square-foot lease with Dollar General at 655 N Shadeland Ave.

| 6.3% | $12.40 | 159,007 | 123,370,384 | 653,101 |
|---|---|---|---|---|
| VACANCY | AVG. SF RENTAL RATES | NET SF ABSORPTION | RETAIL SF INVENTORY | SF UNDER CONSTRUCTION |

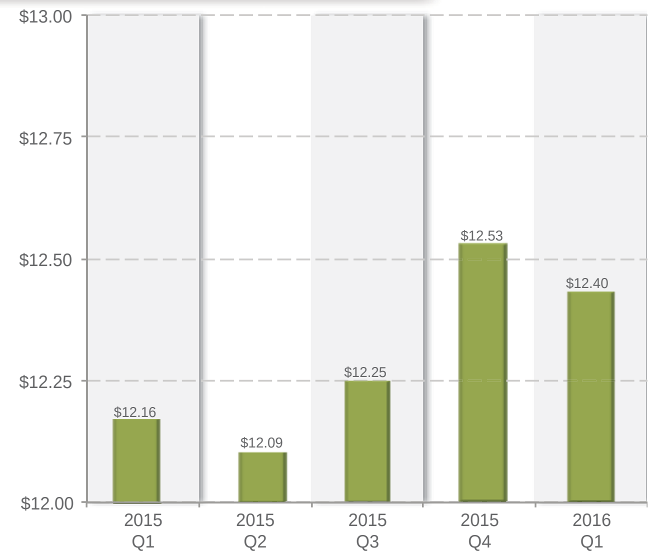
## INDIANAPOLIS - TRENDING NOW (continued)

Net absorption came in at a positive 159,007 square feet for the quarter, compared to 476,925 square feet in Q4. In the last four quarters, a 1.2 million square feet net gain in occupied space has been recorded in a market that has a total retail base of 123.37 million square feet.

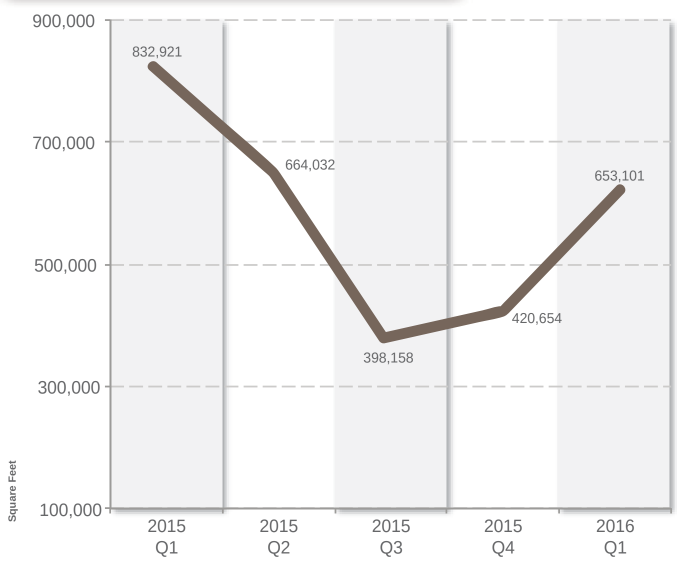
Demand has risen substantially for well-located and anchored retail space from national as well as local tenants, so much so that a shortage of top tier space is forcing activity into secondary centers. Owners of those properties now have their first opportunity since 2008 to boost occupancy levels that will increase the value of their assets. In terms of product type, activity is strongest in the regional and community center categories, followed by grocery-anchored projects. Regional malls doing well include The Fashion Mall, Greenwood Park and College Mall in Bloomington.

Only 67,956 square feet of retail space was delivered during the quarter, but 973,005 square feet completed over the past four quarters. Notable deliveries for Q1 include a 21,588-square-foot building at 13099 Parkside Drive and a 15,000-square-foot building at Meridian and Main Street. The development pipeline is at its highest level since before the recession that began in 2008. Over 653,000 square feet was still under construction as the quarter ended. North County is the most active submarket in terms of new construction, with 458,000 square feet of space underway, with 47% of that total preleased. Mixed use projects lead the way,

AVERAGE SF RENTAL RATES




SF UNDER CONSTRUCTION

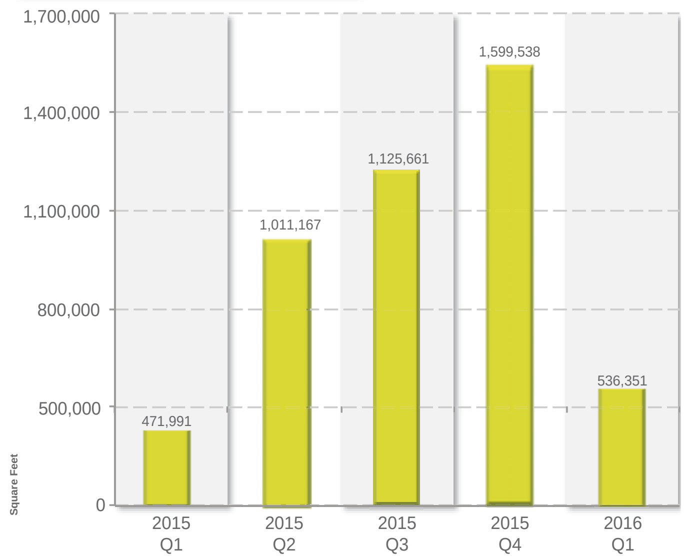



### A LOOK AHEAD

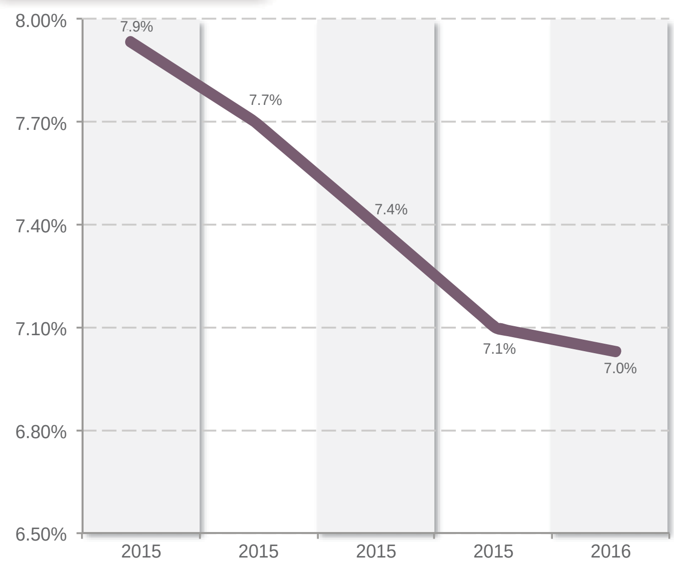
- Lease activity should maintain current momentum throughout the year
- Net absorption will be steady, but could moderate in prime submarkets due to lack of supply
- Asking lease rates will increase by another 3% to 5% by the end of the year
- Construction will increase as several new projects get underway before year-end
- Development costs will rise significantly due to a shortage of contractors
- Cap rates may move higher as more owners, looking to cash out near a market peak, put their properties on the market

# ATLANTA

## NET SF ABSORPTION




## VACANCY RATE




## TRENDING NOW

The Atlanta retail sector kept its momentum in Q1. Job and population growth has been the big story in the region and that has kept retailers in the hunt for new locations, especially in more urbanized areas. Construction activity remains relatively light. Just over 300,000 square feet of new space was delivered during the first quarter and another 1,734,074 square feet is currently underway. Upgrades to existing centers are also in the works. Phipps Plaza, a regional mall, is upgrading its look and adding space to accommodate retail demand for locations in higher income trade areas. But regional centers outside prime submarkets are struggling to keep tenants, as the retail landscape continues its shift to higher density environments as a result of the millennial demographic shift to urban core areas rich in amenities and near public transportation hubs.

Net absorption numbers indicate the continued overall health of the retail property sector. The increase in occupied space for Q1 totaled 536,351 square feet, compared to 1,599,538 square feet in Q4 and 1,125,661 square feet back in Q3. The biggest move-in for the quarter was a 123,000-square-foot lease to Dawson Marketplace Kroger. That helped bring the overall vacancy rate down 10 basis points to 7%. However, vacancy rates vary widely depending on location and product type.

Asking rents are also all over the board. For prime locations in urban locales like Buckhead, rates can exceed $30. But, the overall average asking lease rate moved down $.08 to settle at $12.48 by the end of Q1. Trendy restaurants and entertainment venues are still willing to pay the premium for prime urban locales that appeal to consumers who prefer a compact, integrated

| 7.0% | $12.48 | 536,351 | 355,637,244 | 1,734,074 |
|---|---|---|---|---|
| VACANCY | AVG. SF RENTAL RATES | NET SF ABSORPTION | RETAIL SF INVENTORY | SF UNDER CONSTRUCTION |

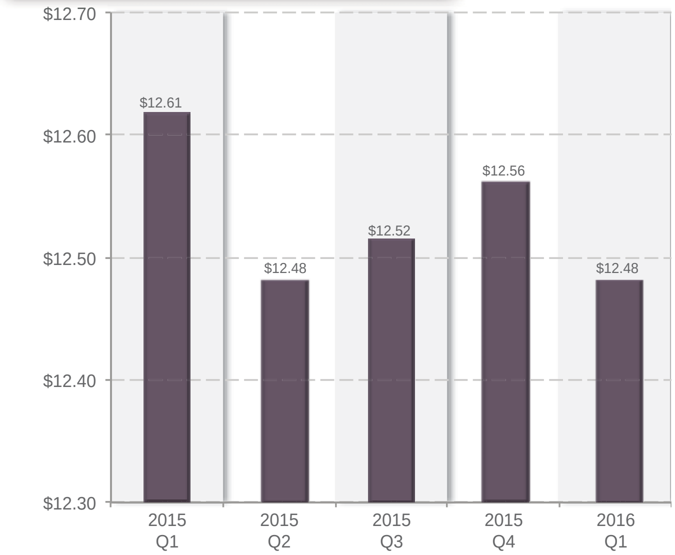
## ATLANTA - TRENDING NOW
(continued)

live/work/play environment. As a result, rents have spiked dramatically in those areas, as they are much preferred over suburban shopping centers in more traditional neighborhoods. Suburban retail property owners are having to take on more risk by leasing to mom and pop store owners, and must do so at sharply lower rental rates. And until the current demographic shift reverses, suburban retail properties will struggle to maintain current occupancy levels.

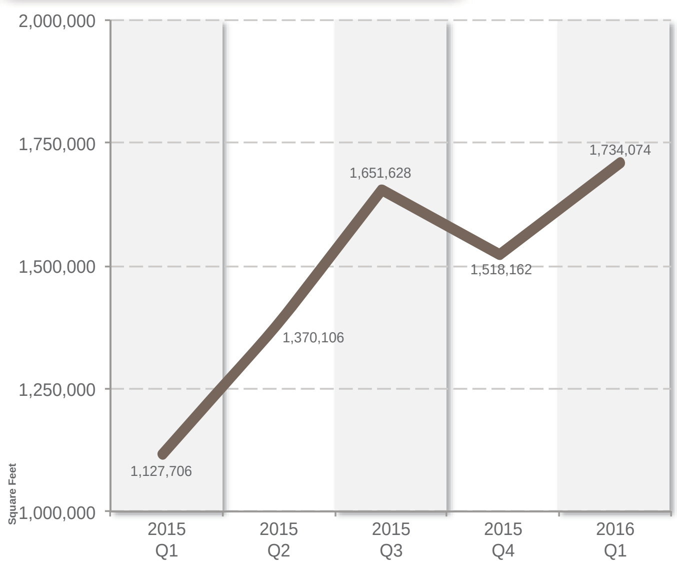
As we reported last quarter, the proliferation of chef-driven dining establishments has helped developers and owners of existing properties attract other tenants who will pay more for destination-type venues. Chef-inspired restaurants do well in Metro Atlanta. At the other end of the retail spectrum, discount retailers like Dollar General are also in expansion mode, which is a relief for existing properties owners who have larger blocks of vacant space. Franchises in the hair care, mailboxes, pizza and burger categories continue to grow, which is welcome news to landlords of unanchored strip centers who have been struggling with high vacancy.

Investor interest in retail properties remains at record levels and pricing has moved up accordingly. However, there is less interest in suburban locations due to concerns over leasing risk. Mixed-use projects with a retail component get particular interest, as assets near the housing and amenities preferred by millennials, are considered to have the most potential for strong occupancy and rent growth. The good news is that Atlanta is a very strong market in terms of job growth, and that will continue to attract investors to the region going forward.

AVERAGE SF RENTAL RATES




SF UNDER CONSTRUCTION

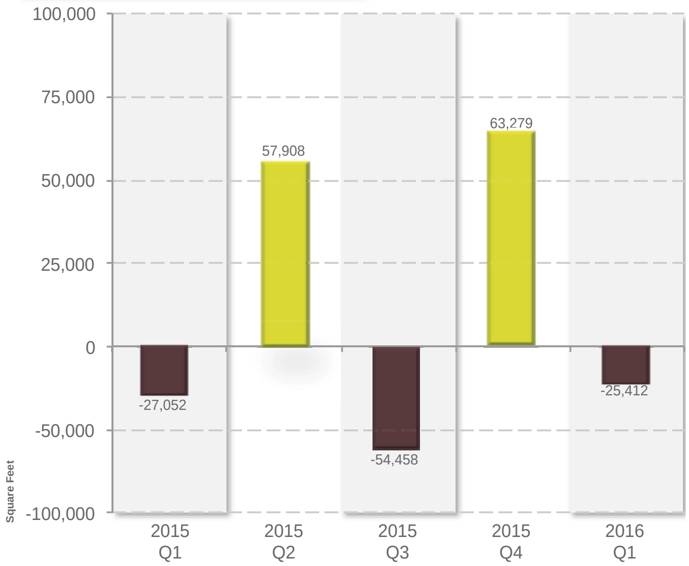



## A LOOK AHEAD

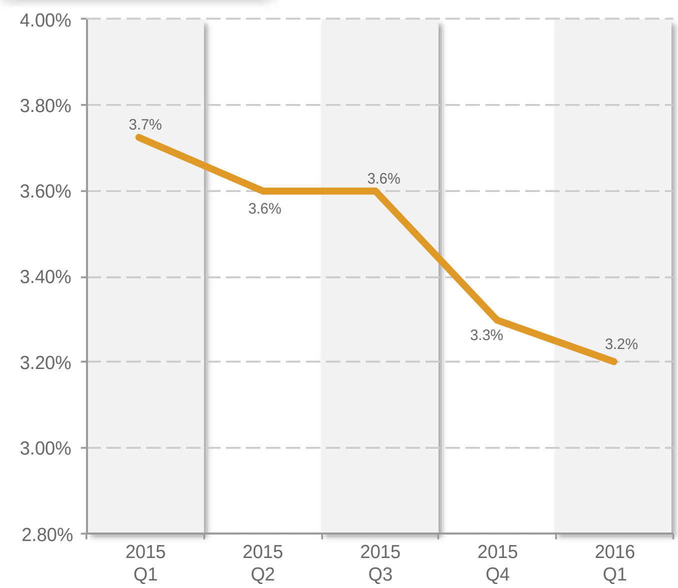
- New retail concepts continue to favor more urbanized areas
- Suburban retail from malls to strip centers will continue to struggle in terms of occupancy and rent growth
- The overall vacancy will remain near current levels, but will continue to fall in prime submarkets
- Average asking lease rates will remain near current levels throughout the year
- Development activity will be light this year, but may increase after the Braves and Falcons stadiums are completed

# MANHATTAN

## NET SF ABSORPTION




## VACANCY RATE




## TRENDING NOW

While Manhattan's overall economy is still thriving, concerns for the retail sector are beginning to surface. Rent growth and leasing activity have made huge gains in recent years, and vacancy has been declining as a result. However, it's the sustainability of those trends that is being called into question.Demand for retail space is still strong in the high-profile office and tourist areas. Times Square, World Trade Center and Soho are still seeing rent increases and strong demand, while the Upper East and West Sides remain stable. It's the secondary areas and neighborhoods that are seeing a falloff in demand and that has developers, landlords and tenants taking a more cautious approach to decision making. Tenants are taking longer to make decisions, and that has put additional pressure on landlords with idled space.

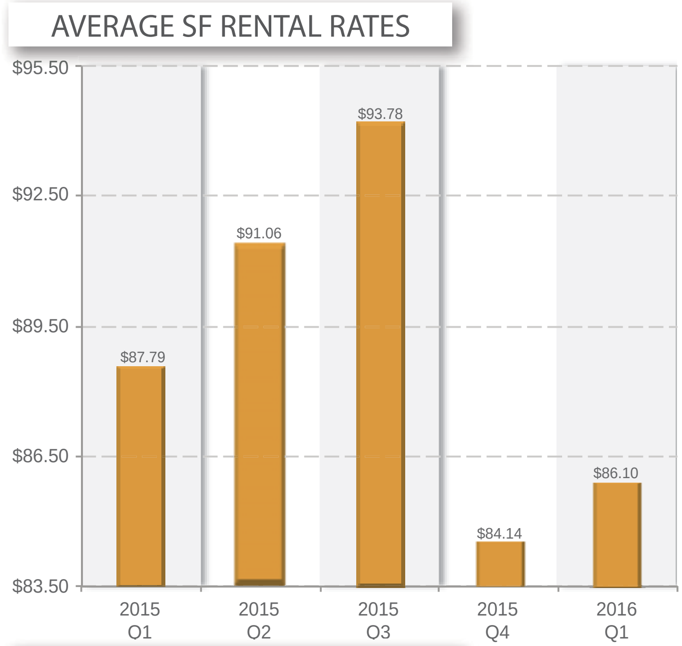
Job growth, the primary driver of retail spending, is still going strong. Year-over-year private sector employment has increased substantially, which should result in more disposable income to spend on retail goods. That has kept luxury retailers from around the world focused on maintaining a strong presence in Manhattan. But net absorption for the last four quarters has been flat due to tight supply, adding just 43,215 square feet to the total of occupied space. New deals contributing to Q1 performance include PIRCH's 30,782-square-foot lease at 200 Lafayette St; Sephora's new 16,100-square-foot location at 580 5th Ave and a 10,094-square-foot store for Musuem of Modern Art Design Store at 79-81 Spring St. Second generation restaurant space is still in demand, but newcomers to the market and small operators are struggling with high taxes, increases in rent and higher food and employee costs.

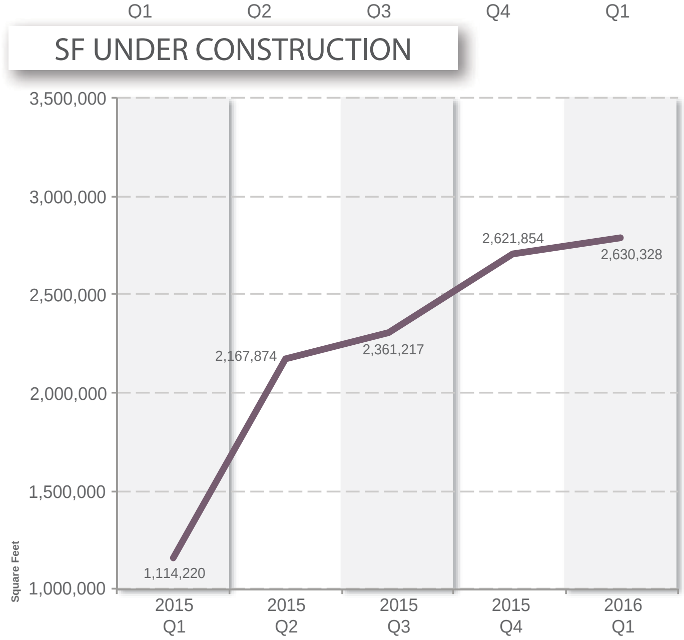
| 3.2% | $86.10 | (25,412) | 51,168,124 | 2,630,328 |
|---|---|---|---|---|
| VACANCY | AVG. SF RENTAL RATES | NET SF ABSORPTION | RETAIL SF INVENTORY | SF UNDER CONSTRUCTION |

## MANHATTAN - TRENDING NOW
## (continued)

The overall vacancy rate in Manhattan fell 10 basis points to 3.2% in the first quarter, and has declined by 50 basis points on a year-over-year basis. Submarkets with the lowest vacancy include Columbus Circle at .4% and World Trade Center, which is 100% occupied. Vacancy is running much higher in the Financial District and UN Plaza. Though Manhattan is one massive CBD, it's so large and diverse that it's important to evaluate market conditions giving full consideration to the significant differences in each submarket.

New retail space is coming on line in major projects like Hudson Yards, World Trade Center and South Street Seaport. Those projects will command premium rents, but that space may take longer to lease up. In Q1, no space was completed, but 2,630,000 square feet of retail is under construction in all of Manhattan. Developers will remain cautious due to concerns of potential oversupply and buyers of properties with retail components are becoming more concerned about the willingness of quality tenants to pay the kind of rents needed to achieve projected returns. High land cost and construction costs, along with regulatory concerns only further complicate development decision making.




## A LOOK AHEAD

- Vacancy will decline in prime markets, but increase in some secondary submarkets
- Asking rents will hold steady for the balance of the year
- Pricing for development sites will see a marginal increase in 2016
- Mom and Pop tenants will continue to struggle due to competitive forces
- Absorption will remain steady
- Construction of approved projects will keep development at record levels

# SELECT TOP RETAIL LEASES Q1 2016

| BUILDING | MARKET | SF | TENANT NAME |
|---|---|---|---|
| 300 Inland Center Dr | Inland Empire | 152,178 | JC Penney |
| The Orchards at Walnut Creek | East Bay/Oakland | 148,560 | Safeway |
| Kroger's | Detroit | 123,330 | Kroger |
| Dawson Marketplace | Atlanta | 123,000 | Kroger |
| Kroger at Bradford Creek | Huntsville | 123,000 | Kroger |
| Future Cub Foods | Minneapolis | 87,680 | Cub Foods |
| South Coast Marketplace | Boston | 80,000 | Market Basket |
| Knoxville Crossing | Peoria | 70,828 | Schnucks |

# SELECT TOP RETAIL SALES Q1 2016

| BUILDING | MARKET | SF | PRICE PSF | CAP RATE | BUYER | SELLER |
|---|---|---|---|---|---|---|
| Springfield Town Center | Washington | 981,399 | $473.81 | 4.1% | Pennsylvania RE Inv Trust | Vornado Realty Trust |
| Shops at Skyview Center | Long Island, NY | 785,000 | $487.08 | 5.5% | The Blackstone Group | ONEX Corp |
| 1001-1045 Lincoln Rd | Miami-Dade | 74,532 | | 3.38% | Ponte Gadea USA | Fryd Properties |
| Eastridge Mall | South Bay | 905,251 | $248.55 | 6.8% | Silverpeak RE Partners | General Growth |
| 837 Washington Street | New York City | 55,497 | | 4.51% | TIAA | Thor Equities |
| East Gate Square | Philadelphia | 746,535 | $251.83 | 5.9% | M&J Wilkow Ltd | Equus Capital Partners |

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# The Lee Retail Brief

Q1 2016

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