The Lee Retail Brief

Q2 2016

1 LEE OVERVIEW

2 NATIONAL OVERVIEW

3 KEY MARKET SNAPSHOTS

4 SIGNIFICANT TRANSACTIONS

5 LEE NETWORK

LEE & ASSOCIATES®

COMMERCIAL REAL ESTATE SERVICES

155% increase in transaction volume over 5 years

$12+ billion transaction volume 2015

Ranked 2nd june 2016 Commercial Property Executive (2016 Top Brokerage Firms)

870 agents and growing nationwide

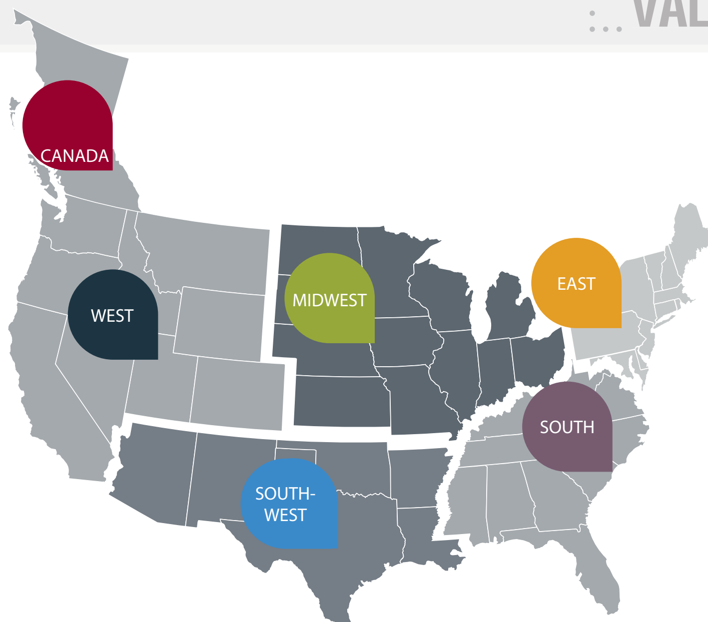
LOCAL EXPERTISE. NATIONAL REACH. WORLD CLASS.

At Lee & Associates® our reach is national but our expertise is local market implementation. This translates into seamless, consistent execution and value driven market-to-market services.

Our agents understand real estate and accountability. They provide an integrated approach to leasing, operational efficiencies, capital markets, property management, valuation, disposition, development, research and consulting.

We are creative strategists who provide value and custom solutions, enabling our clients to make profitable decisions.

OFFICE
INDUSTRIAL
RETAIL
INVESTMENT
APPRAISAL
MULTI-FAMILY
LAND
PROPERTY MANAGEMENT
VALUATION & CONSULTING



THE POWER OF THE LEE NETWORK

Irvine, CA
Orange, CA
Newport Beach, CA
Ontario, CA
Riverside, CA
Los Angeles, CA
Industry, CA
Carlsbad, CA
Stockton, CA
Pleasanton, CA

West LA, CA
Sherman Oaks, CA
Central LA, CA
Temecula Valley, CA
Victorville, CA
Calabasas, CA
Los Olivos, CA
San Luis Obispo, CA
Ventura, CA
San Diego, CA

Reno, NV
Oakland, CA
Antelope Valley, CA
Santa Barbara, CA
Palm Desert, CA
ISG- LA, CA
Boise, ID
Long Beach, CA
Denver, CO

Phoenix, AZ
Dallas/Ft Worth, TX
Houston, TX

Chicago, IL,
St. Louis, MO
Southfield, MI
Madison, WI
Indianapolis, IN
Greenwood, IN
Cleveland, OH
Columbus, OH
Twin Cities, MN

Atlanta, GA
Greenville, SC
Fort Myers, FL
Orlando, FL
Charleston, SC
Valuation, Atlanta

Elmwood, NJ
Manhattan, NY
Edison, NJ
Chesapeake Region
LI/Queens, NY
Eastern Pennsylvania

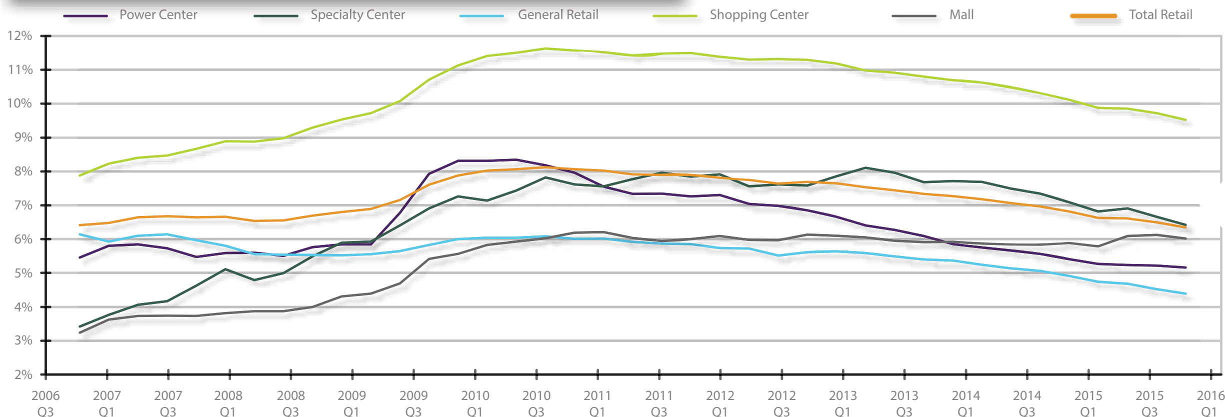
Canada, BC

PROPERTY MARKET TIGHTENS
RETAIL SECTOR PICKS UP THE PACE IN Q2

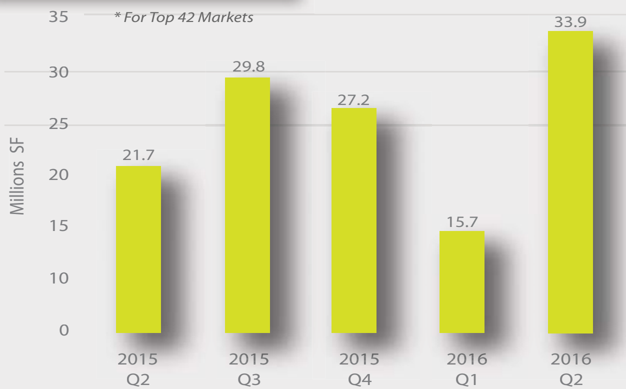
The US retail property market picked back up in Q2 after a disappointing first quarter. Net absorption more than doubled during the period, the vacancy rate resumed its decline and average asking rents moved up again. Construction activity was little changed.

US retail sales rose by 2.6% in Q2 as compared to the same period last years, nearly doubling the quarterly growth recorded in Q1. Of the 13 major retail categories, 11 posted gains, with non-store retailers leading the pack with 12.7% increase in year-over-year sales gains. Food services and drinking places, saw another bump of 5.4%. Health and personal care store sales rose 8.2% over the same period last year. Quarterly gasoline station sales slipped 9.3% year-over-year,

VACANCY RATES BY BUILDING TYPE 2006-2016



NET ABSORPTION



as worldwide surpluses erased price gains earned in Q1. Furniture and home furnishings stores sales grew by 2.1% year-over-year due to improving housing market conditions, while electronics and appliance stores declined by 3.4% for the same period.

The vacancy rate moved lower in Q2, shedding 20 basis points to settle at 5.2%. In the past year, a 40-basis point decline in the vacancy rate has been realized. As reported last quarter, vacancy is sharply higher in secondary locations and nearing 0% in prime submarkets. General retail (freestanding, general purpose properties) posted the lowest vacancy of all retail property types at 3.3%, down 40 basis points in the quarter, followed closely by Power Centers at 4.5%, unchanged in Q2. Shopping Center (neighborhood, community and strip centers combined) rates are still highest at 8.3% despite a 40 basis point decline in the period. Excess supply in this category is concentrated in suburban submarkets that have fallen out of favor with expanding retailers.

Urban areas continue to account for a greater share of net absorption performance as more retailers look to younger consumers for sales growth. These younger consumers, who seem to prefer multifamily housing near public transportation, hip restaurants, cool bars and entertainment venues, are attracted more to the amenities and less about owning single family homes that increase commute times.

ECONOMIC DRIVERS

GROWTH

EMPLOYMENT

MONETARY POLICY

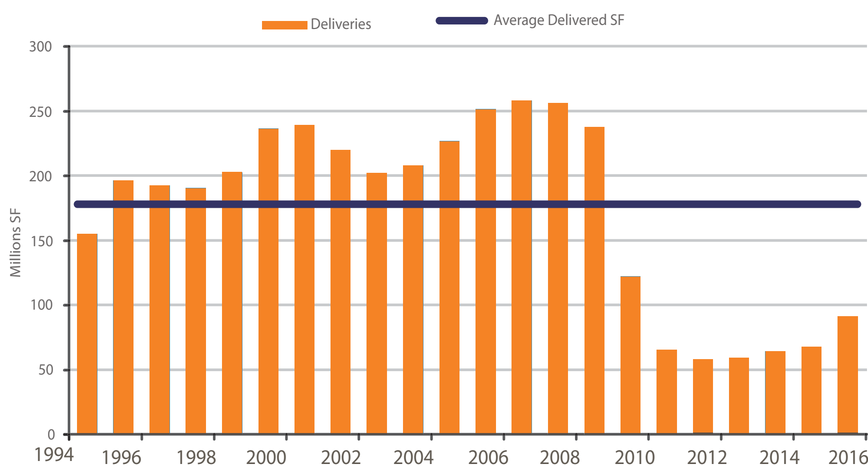
GLOBAL ECONOMY

A LOOK AHEAD

Q2 net absorption more than doubled Q1's total, finishing the period with a net gain of 43.4 million square feet. In the past four quarters, just over 136 million square feet of net absorption has been recorded, a very impressive number given the fact that overall retail sales and wage growth have both been disappointing throughout the economic recovery. The overall average asking rate moved up another $.14 to $15.46 per square foot in Q2. Over the past four quarters, retail rents across all product types and locations moved up by 2.1%, but rent growth was concentrated in urban locales. Suburban retail centers, especially mid-block strip centers that cater to mom and pop retailers, have seen weaker growth and more persistent vacancy. The rate of rent growth declines as distance from an urbanized core increases, a trend that has been ongoing for the past several years.

New deliveries for the quarter totaled 17 million square feet, bringing the total of completed inventory in the past four quarters to 84.6 million square feet. Another 74.4 million square feet is currently under construction. In keeping with retailer preferences and their willingness to pay more, urban locales are seeing the bulk of new construction.

HISTORICAL DELIVERIES 1994 - 2016



Traditional, brick and mortar and online retailers continue to move toward greater balance to boost sales. Online retailers are adding physical locations as more traditional retailers are boosting their online presence and closing down underperforming physical locations. Macy's, Walmart and Sears have all announced major store closings, while big sporting goods retailers Sport Chalet and Sports Authority decided to call it quits in the first half of the year. After a merger with Staples failed, Office Depot announced its decision to consolidate operations by closing 300 more locations across the country, further evidence of how the prolific growth in online sales continues to erode the market share of traditional retailers across the retail spectrum.

A LOOK AHEAD

The US retail market will keep growing, but further gains will be hard fought. Weak GDP and wage growth numbers will put downward pressure on retail sales volume. It remains to be seen if Q2 consumer spending will reinvigorate retail sales. Imported goods will remain cheap due to the strength of the US dollar, and that will keep the discount retailers busy expanding. Oil prices moved up in Q1, but reversed course by the end of the quarter. Central banks around the world have resorted to negative interest rate policies to reduce the risk of a deflationary cycle. Results of that effort have been disappointing. So, expect the price of imported goods to remain near current levels for the time being.

Low oil prices have been with us for two full years now, but the boost in domestic retail sales that was expected as a result of an increase in disposable income, has been disappointing at best. Job growth, while still positive, is decelerating in terms of the 12 month rolling average. Q2 earnings season was a mixed bag, with many major corporations resorting to cost-cutting and stock buy-backs to improve profitability and earnings-per-share performance. Without higher wages, retail sales growth, vacancy and net absorption will likely follow the current trend line for the balance of the year.

Oversupply of capital to invest will keep yields on retail investment properties compressed, expect lenders to tighten underwriting standards and demand and lower loan-to-value ratios. Foreign investor demand will keep the pressure on supply, as they look even more to US markets as a safe haven.

GDP GROWTH

After a dismal showing in the first quarter of 2016, the first estimate of GDP growth for Q2 came in at just 1.2%, less than half of what was expected. Inventories, thought by most experts to be on the rise, declined substantially. However, a 4.2% increase in consumer spending kept economic growth from being even more of a disappointment. Adding to concerns over chronically sluggish GDP was the downward revision of Q1's growth rate to .8% from 1.1%. Anemic growth in Europe, Japan and most of the world's other economies isn't helping sentiments here at home either. Despite massive central bank interventions to stave off a deflationary spiral, little progress has been realized.

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 US equities. Fortunately, those losses were recovered late in Q1, and the Dow Jones Industrials

QUARTER-TO-QUARTER GROWTH IN REAL GDP

Average surged back up to 18,000. The problem is there was little to point to for that to be the case other than fear. But, the "Brexit" vote in late June surprised just about everybody and the Dow took another dive on the news. Four days later, the Dow set a new record high on July 8th.

Volatility in equities has become commonplace and savvy chief executives are going take that into account as they make decisions for their companies that will show up in GDP numbers down the road. Now, volatility and uncertainty seems to be the rule of the day no matter what the topic may be. Output of US goods and services are becoming more expensive around the world, and that fact will impact the net investment in business and the trade deficit, both major components of GDP. It now looks like US GDP growth will lag behind 2015's final tally of 2.4%. There just doesn't seem to be enough evidence to expect anything more, as nominal increases in consumer and government spending (the other components in the GDP equation) will not be enough to make up the difference. The fact is that our economic growth is anemic despite unprecedented action by our central bankers to give the economy a booster shot.

GDP GROWTH

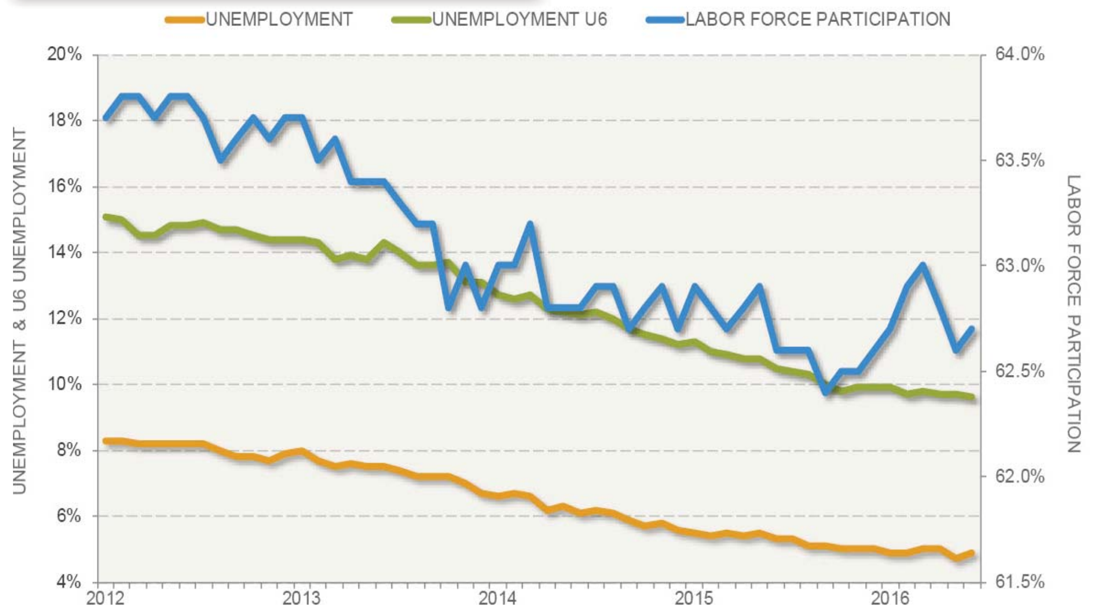
Consumer spending, which accounts for roughly 70% of GDP, and the numbers don't look good. As we pointed out last quarter, US consumers are keeping a firm grip on their wallets because they're pessimistic about what's to come economically. Retail sales, a large component of consumer spending, has made some modest gains of late, but it did nothing more than make up for declines earlier in the year. Wage growth, or lack thereof, has been a persistent problem throughout this marathon of a recovery, and it is central the issue impacting consumer spending. Income growth is running just above 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 kind of purchases that will move the GDP needle in any significant way. Instead, they continue to pay down existing debt, which doesn't contribute a penny to current GDP.

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 have become more expensive abroad and the impact to US companies who sell products and services that are paid for in other currencies, has been substantial. Exchange rates fluctuate daily, but it's safe to say that the dollar will remain strong as long as the current level of economic uncertainty persists. If other countries voluntarily devalue their currencies to increase the competiveness of their exports, the US Dollar will soar and things could get worse for American companies that have substantial exposure to foreign markets.

EMPLOYMENT

Predicting job growth numbers is getting tougher each month. A year ago, the average monthly increase for non-farm employment over the previous 12 months was well over 200,000 new positions. That number has fallen substantially, and the monthly numbers are getting more erratic. Q2 is a good example. April's total was 144,000. The latest estimate for May came in at 11,000 and the first estimate for June was 287,000! How do people make big business decisions with numbers like that? The simple answer is: they get more careful about every decision they make. When they get more careful, they tend to spend less. When they spend less, they hire fewer people or lay more people off. Those people have less to spend.

The interesting thing here is that despite the erratic job growth number, the U3 unemployment rate (the index most widely used) is at a very low rate of 4.8%. Our Econ 101 professors taught us that an economy with 5% unemployment rate is fully employed. If it were only that simple. Tell that to the worker making close to minimum wage who doesn't have the skills for a better job, has a high level of skill for a job that doesn't exist or can only find part time work. The U6 unemployment rate, which accounts for part-time workers who would prefer to work full time in their field, is at 9.7%. This index tells a different and perhaps more telling story about the realities of the US economy; too many people working at jobs that don't pay the bills. For these folks, discretionary income is a concept not a reality.



Another way to get a clearer picture of the job numbers is to look at employment by business sector. Unfortunately, doing so makes things look even worse. For example, over 140,000 of the 287,000 jobs created in June were in Leisure and Hospitality, Retail Trade and Healthcare and Social Assistance. These are generally lower-paying jobs that can disappear quickly as things change. By contrast, manufacturers hired 14,000 workers, and gains in construction jobs amounted to zero. Another 15,000 were hired on a temporary basis, and the total hours per worked on a weekly basis was unchanged from a year ago at just over 34 hours. The key manufacturing index compiled by the Institute of Supply Management (ISM) has spent most of the past year in negative territory.

Concerns over slowing domestic growth and the prospect of recessions abroad is prompting employers to hire more part time and temporary workers. The cost of health care pursuant to the Affordable Care Act (ACA) is also contributing to part time employment problems, as employers are inclined to hire workers just under the 30 hour per week threshold that would require them to provide health benefits.

EMPLOYMENT

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, have combined to keep just 62.7% of potential workers in active production.

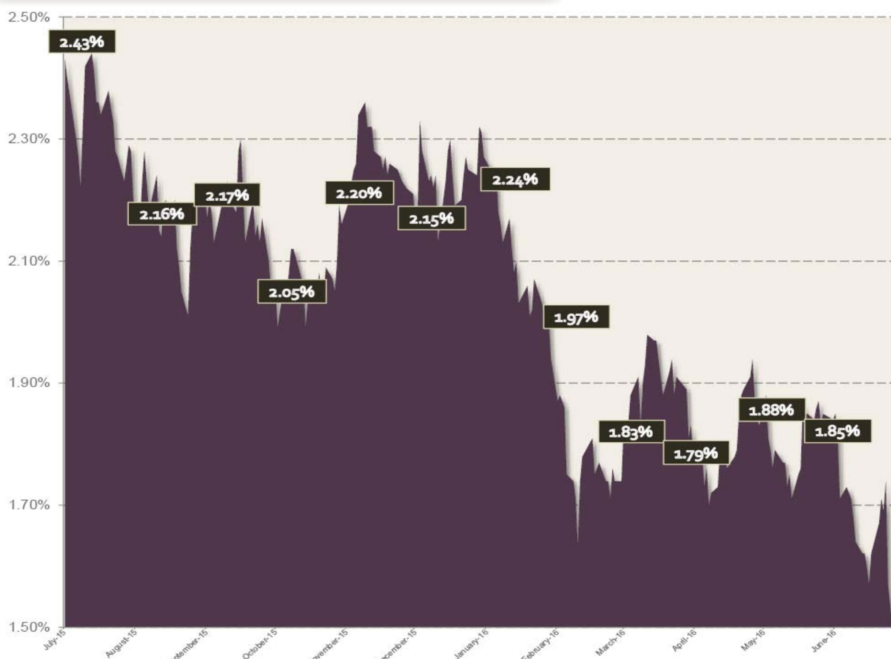
Wage growth is another problem that has dogged the US economy. While the general unemployment rate fell to 4.8% by the end of June, full-time, high-paying jobs are in short supply and wage growth overall is tracking at a rate of approximately 2.5%. For a worker making close to the minimum wage, that kind of growth is nothing to celebrate. This is one of the reasons why so many middle class workers feel left behind.

Ironically, many of the best-paying positions that are available go unfilled for lack of qualified candidates. 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 Q2 idling more wells, laying off more workers and slashing capital budgets. So, further job losses in that sector can be expected.

MONETARY POLICY

In December of last year, the US Federal Reserve Bank's open market committee finally pulled the trigger and boosted the Fed Funds rate by 25 basis points to .5%. While it had little immediate effect here at home, the rest of the world reacted, stock markets slid and the dollar strengthened against most of the world's currency. At the same time the European Central Bank was sending interest rates into negative territory and was buying 60 billion Euros worth of bonds each month in its own version of QE. Not exactly a well-coordinated effort, but that wasn't Congress' idea when they created our central bank back in 2013. 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 action reduced uncertainty about the policy direction in the beginning, but now Ms. Yellen has backed off the clear talk and returned to more familiar cryptic language when discussing the Fed's future actions. Though, most experts now agree that circumstances are too shaky around the world for the Fed to raise rates anytime soon. That may be the main reason why the Dow Industrials Average hit a record high on July 8th.

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, and they should be even happier now, as it appears that the days of cheap capital will be with us a while longer, and mortgage interest rates may even move lower in the coming months. The yield on the 10 Year US Treasury Bill has moved to a record low under 1.5% of late. It's that rate that is used as the index for most mortgage loans made on commercial real estate. It probably also means that the danger of cap rate decompression, a very real concern as it relates to real estate valuations, is abated at least for time being because borrowers will still have access to capital at a rate less than current cap rates. When the Fed finally follows through with more rate hikes, 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.

Keeping a close eye on what central bankers are up to around the world is a good idea. It seems that more drastic measures are being taken every day somewhere around the world, including the newest stimulative tool, negative interest rates. Imagine paying someone interest for the privilege of loaning them money. Sounds crazy, and it might be. But, it is also where over $10 Trillion has recently been "invested."

GLOBAL ECONOMY

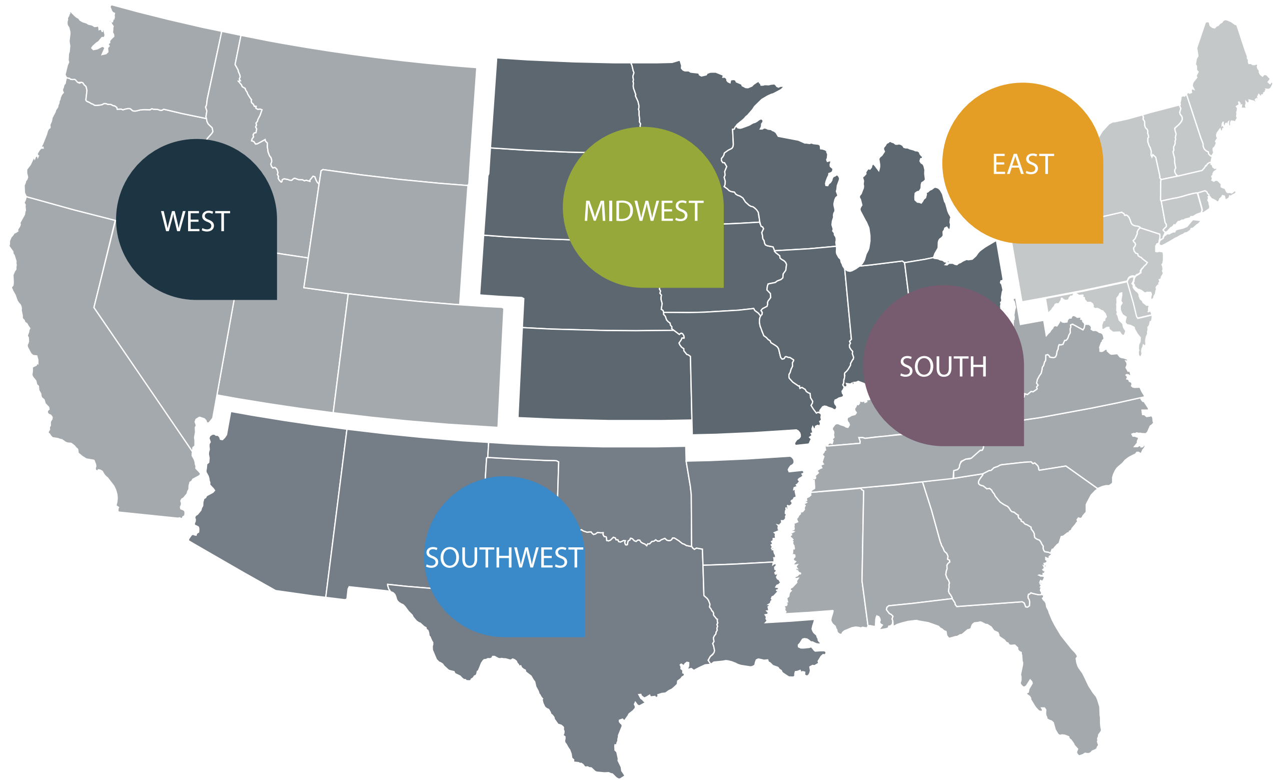
Last quarter we described the global economic outlook as troublesome. As it turned out, we were wrong. It's worse than troublesome. It's downright scary and increasingly complex. The stakes are high and the outcome of the current global economic conundrum is anything but certain. Whether the topic is 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 like Brazil and Venezuela that depend almost entirely on the export of raw materials and oil, are mired in recession with runaway inflation.

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

Then came Brexit, the UK vote to leave the European Union. Few gave it a chance and the shock wave from the vote was instantaneous. Europe's political union in constant crisis mode these days and there is no governing body with the real authority to enforce anything. EU leaders and European Central Bank have been ineffective in terms of getting things on track. Sovereign debts are mounting, unemployment is persistently high dismal economic growth in Europe makes the US economic look positively dazzling. Concerns over deflation are driving the European Central Bank to send interest rates into negative territory. The bank is also buying up sovereign bonds and has even resorted to buying corporate bonds, an action that would be illegal in the US. Calls for austerity from nations swimming in debt been largely ignored, and the recent refugee crisis is exacerbating economic problems and reigniting nationalist fervor throughout Europe. Many credit concerns over immigration for the surprise passage of the Brexit referendum in the UK. If nothing else, that vote brought the differences between European nations back into the light. The fate of the European Union is uncertain at best, and that bodes well for the US commercial real estate market. For all our failings, the US is still considered the safest place to keep money in troublesome times. The flight to safety phenomenon has already driven US Treasury yields to all time lows.

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 sluggishly so, 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 operating 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 the Fed's 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 2016 to be another year of so-so economic growth and more of the same for commercial real estate. All things considered, there's no place like home.

Key Market Snapshots



ORANGE COUNTY
SAN DIEGO

DALLAS/FT WORTH

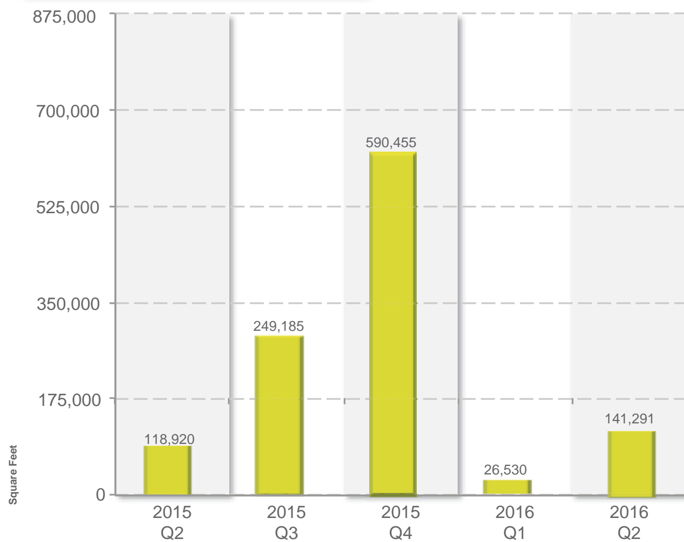
INDIANAPOLIS

ATLANTA
GREENVILLE/SPARTANBURG
CHARLESTON

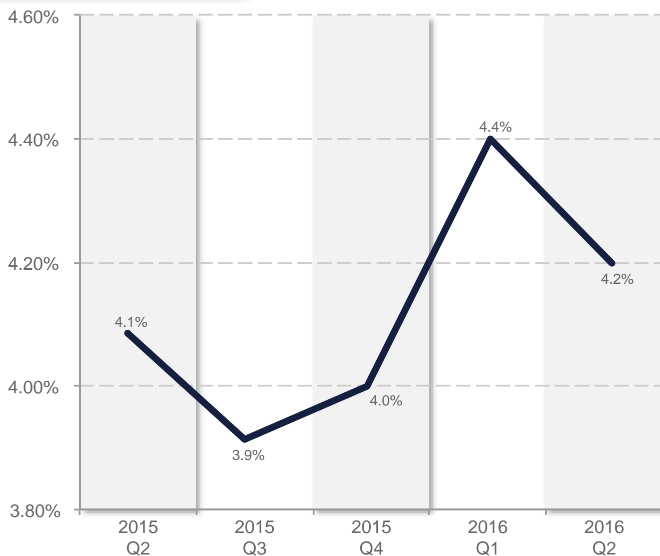
MANHATTAN

ORANGE COUNTY

NET SF ABSORPTION



VACANCY RATE



TRENDING NOW

The economic growth rate of Orange County continues to outpace all but a few of the state's 58 counties. The OC is on track to create another 42,000 new jobs in 2016, slightly less than in 2015. Fortunately, expansion in the tech, business services and health services sectors has been strong, and that means more full-time, higher-paying jobs are on offer. Nationally, job growth has been slowing and a disproportionate share of jobs being created are unskilled and semi-skilled that pay less or are offered on a part time basis. In Orange County, the unemployment rate keeps moving lower, finishing Q2 at just 3.6%, well ahead of the national rate of 4.8%. The nearly fully employed local economy continues to drive steady gains in the housing sector, giving retailers good cause to keep expanding.

But not all the news is good. Landlords are becoming more concerned with an increase in store closings among chain retailers, and the depth of new prospects to backfill vacated space. The shutdown of Sport Chalet and Sports Authority has impacted shopping centers throughout the county, as have moves by the likes of Kohl's and Albertsons, as these big players juggle locations to optimize market coverage. Concerns over a potential market correction are also on the rise, as many landlords see the economic recovery getting long in the tooth. Though, they welcome recent news of strong growth in Q2 consumer spending, which surprised the experts by posting a 4.2% rise at the national level.

Vacancy declined 20 basis points in Q2 to 4.2%, after slight upticks in Q1 and the last quarter of 2015. The occupancy picture varies widely by submarket. Space in prime locations in the coastal submarkets is in short supply. But, local tenants found in B and C centers are struggling to compete with major chains and online

4.2%	$25.45	141,291	143,931,016	170,592
VACANCY	AVG. SF RENTAL RATES	NET SF ABSORPTION	RETAIL SF INVENTORY	SF UNDER CONSTRUCTION
▼	▲	▲	▲	▲

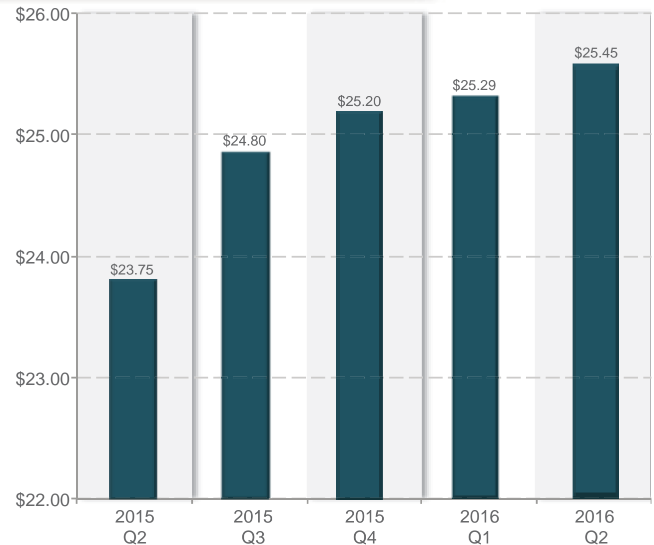
ORANGE COUNTY - TRENDING NOW (continued)

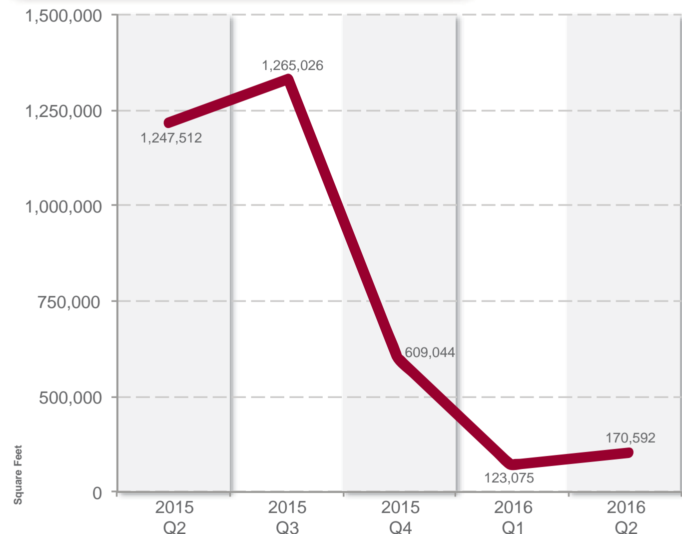
retailers. So, vacancy is running higher in those locations. However, the average asking lease rate still managed a $.16 gain in Q2 to finish at $25.45. Year-over-year, the increase in asking rents topped 7% for all product types countywide. Power Centers and Regional Malls did not fare as well in terms of rent growth, though. Both categories posted year-over-year declines in asking rental rates, while the General Retail category posted a strong increase.

Net absorption for Q2 posted a gain of 141,291 square feet, compared to a 26,530-square-foot gain in the first quarter. Significant quarterly increases in occupied space are becoming harder to produce given the low vacancy rate and lack of new construction. Just 33,307 square feet of new retail product was delivered in Q2 and only 170,592 square feet was in the construction pipeline. Significant move-ins during the period include Gelson's 48,000-square-foot lease on Crown Valley Parkway, Smart & Final's 43,000-square-foot lease on Yorba Linda Blvd, and U Gym LLC's move into 42,343 square feet on Beach Blvd.

Power Centers are still the focus for Target, Walmart, Kohl's, Smart & Final, Bed, Bath & Beyond and REI, all of which will continue to expand in well-located centers. Landlord's in these centers are adding restaurant pads and food courts to boost customer traffic, as eating establishments are not at risk from online competition.

Grocery stores, pet stores and fitness centers also remain in expansion mode. Smart & Final inked a 38,068-square-foot lease on Plano Trabuco Rd in Trabuco Canyon in Q1 and PetSmart recently announced a new 25,952-square-foot store on Aliso Creek Road. Trader Joe's is still expanding, but is focused on urban core locations.



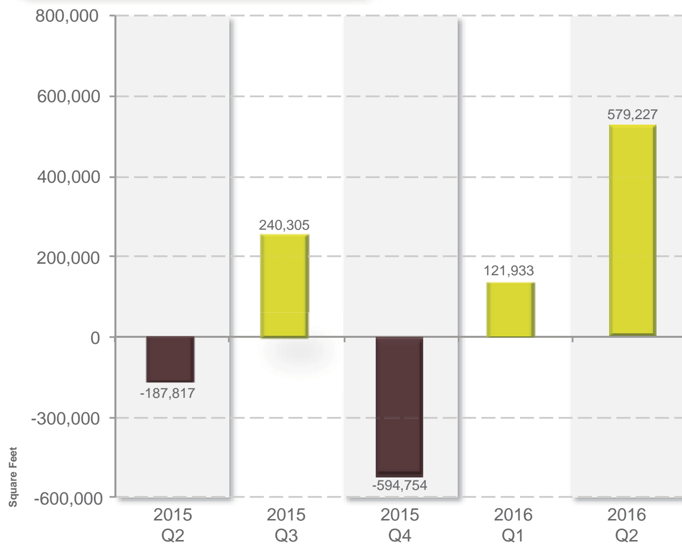


A LOOK AHEAD

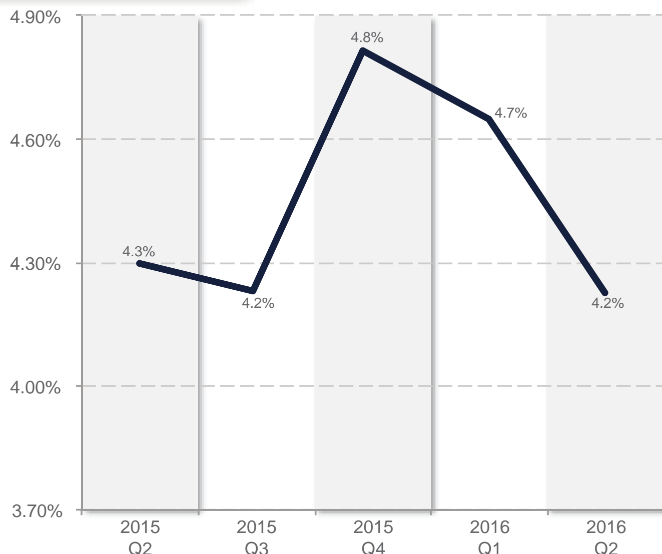
- Supply of good quality product will continue to run short of demand
- The vacancy rate will remain relatively flat going forward
- Net absorption will be restricted by a shortage of prime space, and may dip into negative territory in the coming quarters
- Overall lease rates will remain flat in 2016, except in prime coastal submarkets
- Sales prices may be peaking as rent growth will likely flatten out as we move into 2017
- Construction will be limited to infill and rehab of existing shopping centers

SAN DIEGO

NET SF ABSORPTION



VACANCY RATE



TRENDING NOW

The San Diego retail market remains relatively strong at the midpoint of 2016. The general economy is healthy and unemployment, currently at just 4.2%, is running well below the national rate. While job growth continues, lagging growth in wages makes it difficult for many residents to cope with San Diego's relatively high cost of living. Rental rates for multi-family units have risen sharply over the past several years, leaving less disposable income for retail purchases by residents. However, this hasn't dampened investor interest, as prospective (or potential) acquirers of retail property in San Diego must compete aggressively for its limited supply.

Overall average asking lease rates continued downward, falling by $.29 to $22.12 in Q2. While year-over-year the average rate is down by $.35, substantial gains were recorded in Q4 of 2015 and Q1 of 2016. These swings are indicative of the disparity in rates for prime properties located in urban core areas versus those located in strip centers of outlying suburban submarkets, where "mom and pop" retailers are highly concentrated because of their inability to compete with national tenants willing to pay premiums for superior locations

Simply stated, prime locations, especially in more urbanized areas, are experiencing strong rent growth, while secondary suburban centers struggle. Fortunately, vacant anchor stores are quickly leased by other grocery chains, discount stores and fitness clubs. Landlords of well-located centers are seeing multiple offers for prime spaces, allowing them to increase rates and tighten concessions.

4.2%	$22.12	579,227	135,070,676	429,749
VACANCY	AVG. SF RENTAL RATES	NET SF ABSORPTION	RETAIL SF INVENTORY	SF UNDER CONSTRUCTION
▼	▼	▲	▲	▲

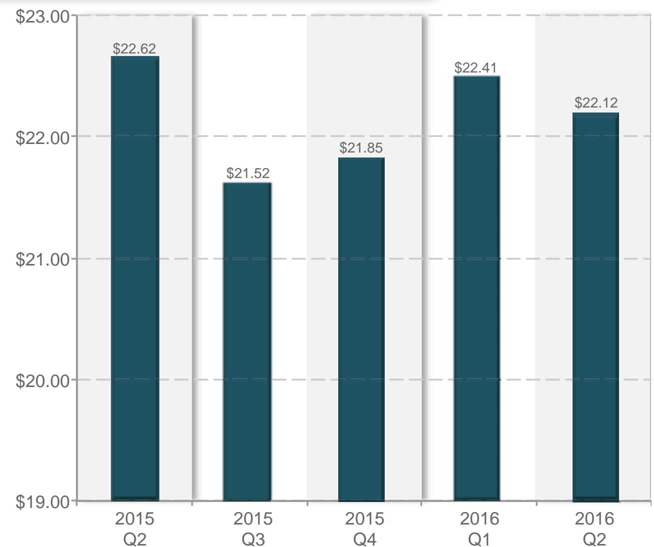
SAN DIEGO - TRENDING NOW (continued)

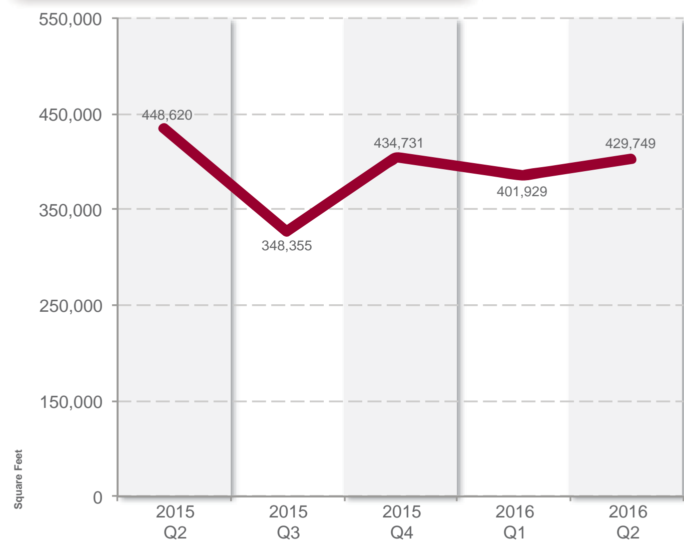
Net absorption remained strong in Q2. Over 579,000 square feet of net gains were reported, following a 121,933-square-foot gain in Q1. The East and North County regions led the way through the first half of the year at 341,000 and 305,000 square feet, respectively.

The overall vacancy rate in Q2 dipped 50 basis points, to 4.2%, but that is only 10 basis points lower than it was at this same time last year. The I-15 Corridor posted the highest vacancy rate at 6.1%. East County's vacancy rate of 3.0% was lowest while Central County's rate came slightly higher at 3.2%. Deliveries in the county remain light, with just over 100,000 square feet of new product added this year to its 135 million square-foot inventory.

Only the South Bay and North County markets have substantial amounts of space under construction, at 238,000 and 123,000 square feet respectively. Construction elsewhere is mostly limited to the remodeling, expansion and repositioning of retail projects due to a lack of available land for ground-up development. With such low levels of new construction, availability should tighten further, which should benefit owners of suburban centers experiencing high vacancy.

The largest leases signed this year include a 50,511-square-foot Vons grocery store at Torrey Highlands Shopping Center, Eastlake Speed Circuit Kart Racing's 45,794-square-foot deal at 851 Showroom Place and PetSmart's 42,417-squarefoot lease in Chula Vista.





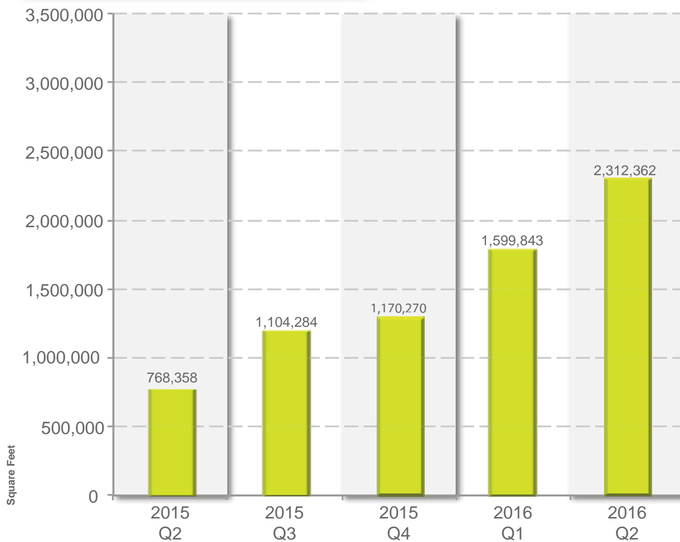
A LOOK AHEAD

- 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

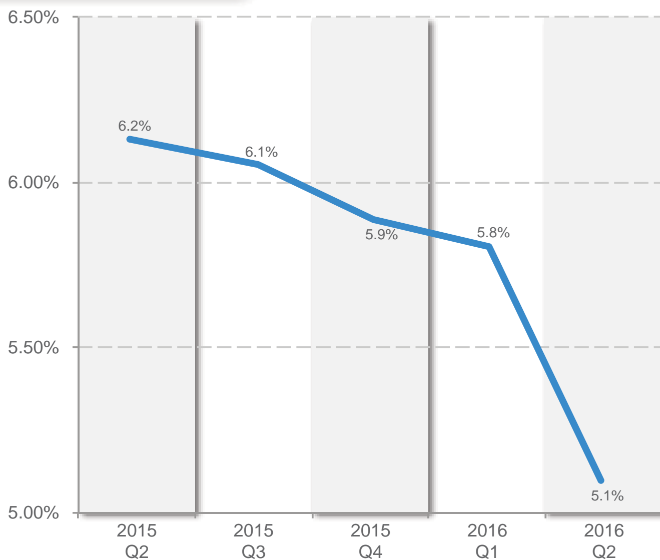
DALLAS / FT WORTH

TRENDING NOW

NET SF ABSORPTION



VACANCY RATE



While bad news in Texas' energy towns has been grabbing the headlines in the past year, the Dallas/Fort Worth area (DFW) area has continued to lead the country in terms of population and job growth. That bodes well for the DFW retail property sector, as more jobs means more disposable income for retail purchases. Demand for consumer services and products has been strong throughout the North Texas area, as the region is only nominally affected by the slowdown in the energy sector, which has hit oil towns like Houston very hard.

DFW is better known as an active distribution hub and a place for major companies to establish headquarters facilities. Toyota, State Farm Insurance, JP Morgan Chase and other corporate users believe that the lower cost of living, vibrant housing market and Texas lifestyle make it easier to attract and retain the employees they need to grow their operations. The retail market has flourished as a result.

Retail vacancy continued its decline again in Q2, paring another 70 basis points to settle at 5.1%. Year-over-year, vacancy is down by 110 basis points. As a result, net absorption has been consistently positive. At midyear, almost 3.9 million square feet of net absorption has been recorded year-to-date, with 2.3 million square feet of that coming in the second quarter. Year-over-year, retail occupancy is up by 7.4 square feet. Lease signings for the quarter included the 44,000-square-foot lease for Carnival Food Stores at Buckner Bruton Retail Building and the 37,500-square-foot lease to Flix Brewhouse at 1690 FM 423.

Average asking lease rates including all retail categories for the quarter dipped by $.03 to $15.05. Year-over-

5.1%	$15.05	2,312,362	408,418,676	3,535,198
VACANCY	AVG. SF RENTAL RATES	NET SF ABSORPTION	RETAIL SF INVENTORY	SF UNDER CONSTRUCTION
▼	▲	▲	▲	▼

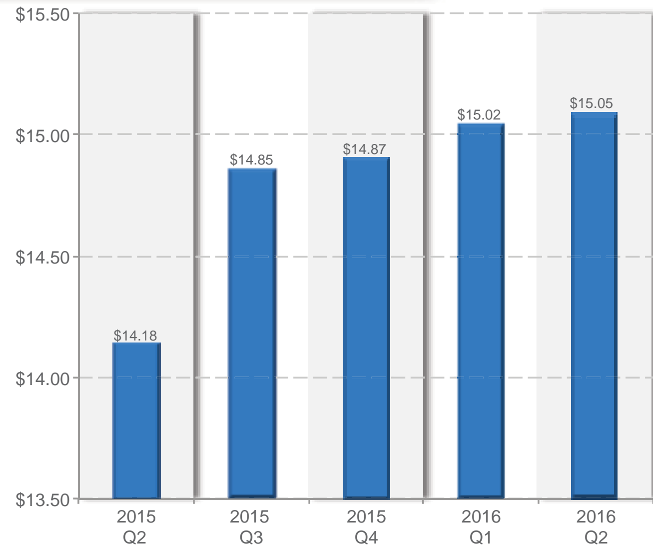
DALLAS / FT WORTH - TRENDING NOW (continued)

year that rate is up by 1.26%. Rents are rising faster in prime areas, forcing some tenants to opt for secondary locations. Power Centers continue to experience the highest rent levels with an asking rate of $30.86, but demand for big box locations is being impacted by the rise in online sales. Regional mall asking rents ending Q2 at $22.08, up $3.20 year-over-year. As in other major markets around the US, the best malls are performing well, but those in secondary locations, anchored by traditional department stores, are struggling.

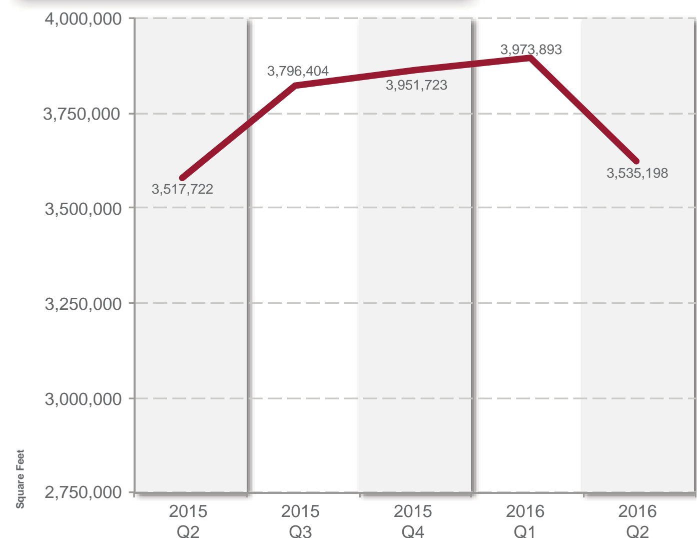
By center type, it's the mixed-use projects in the suburbs and in Uptown near the Central Business District (CBD) that are performing best. These centers tend to have lower vacancy and tenants have little room to negotiate on lease rate.

New deliveries for the entire region in Q2 included 38 buildings totaling 982,168 square feet. Construction activity has been steady, averaging nearly 5 million square feet per year for the past three years. In Q2 of 2016, over 3.5 million square feet of new space was still in the construction pipeline. Strong leasing activity has kept fears of overbuilding to a minimum for the time being, but uncertainty over the national and global economies is a real cause for concern as far as retail sales growth is concerned. Also, corporate earnings have been cooling off of late, and that could impact hiring decisions going forward.

AVERAGE SF RENTAL RATES



SF UNDER CONSTRUCTION

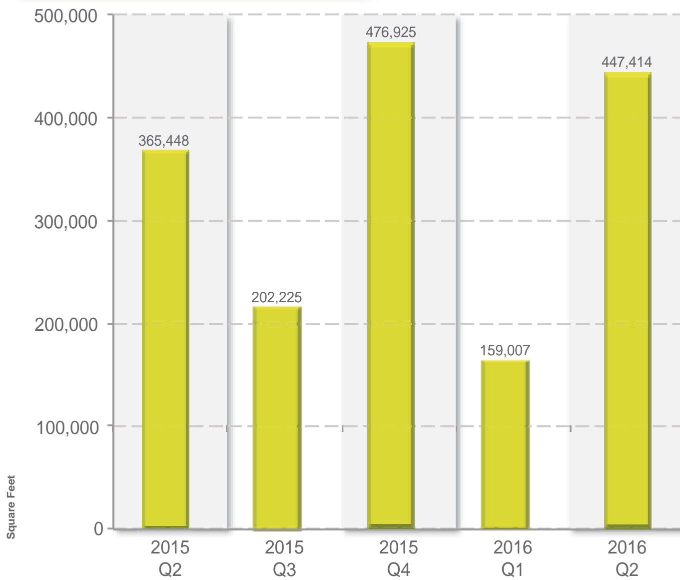


A LOOK AHEAD

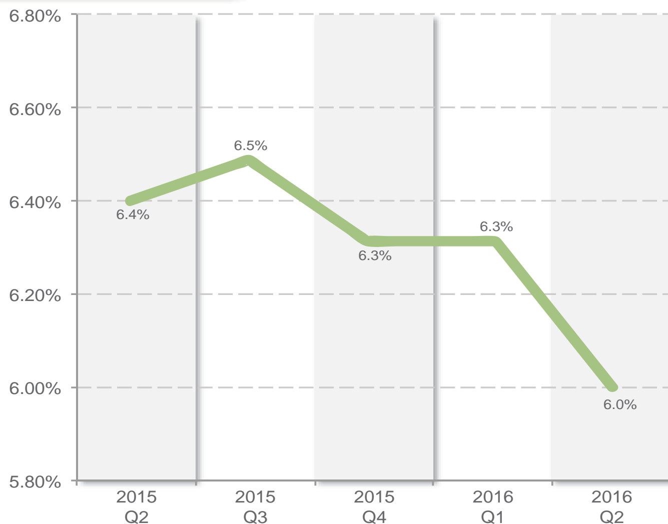
- Gross sale and lease activity should increase due to continuing population growth
- Net absorption should remain strong
- Vacancy, already at historic lows overall, will be lowest in infill markets
- Average asking lease rates will keep moving higher
- Construction will increase, particularly in the Far North Dallas area

INDIANAPOLIS

NET SF ABSORPTION



VACANCY RATE



TRENDING NOW

The Indianapolis retail sector continues to tighten. Leasing activity remains strong across the region, driven by the continuing push of millennials and empty nesters to areas that have the amenities that favor a more convenient life style. Job growth, fueled by business expansion funded by robust venture capital activity, has boosted incomes throughout the region and prompted retailers to respond with new retail concepts. The Fishers submarket, in particular, has been a beneficiary of this trend.

Vacancy declined by 30 basis points in Q2 to 6.0%. The general retail category has the lowest vacancy rate at 2.8%. Mall vacancy ended the period unchanged at 5.9%, while power center vacancy fell slightly to 8.0%. The shopping center category posted a rate of 10.4%, down 20 basis for the period.

The average asking rental rate fell $.04 to $12.36 per square foot for the period, which was $.27 higher than it was a year ago. However, the average rate doesn't reflect the fact that rents have moved much higher for quality space in prime submarkets. As an example, quoted rates in the North County submarket hit $22.55 in Q2, highest in the region, while the rate in West County finished the period at just $8.66.

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. In 2016, major lease signings include the 27,400-square-foot lease by Ross at Castleton Point Main, another Ross lease of 25,369 square feet at Southern Plaza on S East Street, and an 18,000-square-foot lease signed by Party City at 8707 Hardegan Street. Leasing activity in anchored suburban centers is as strong

6.0%	$12.36	447,414	123,766,227	626,987
VACANCY	AVG. SF RENTAL RATES	NET SF ABSORPTION	RETAIL SF INVENTORY	SF UNDER CONSTRUCTION
▼	▼	▲	▲	▼

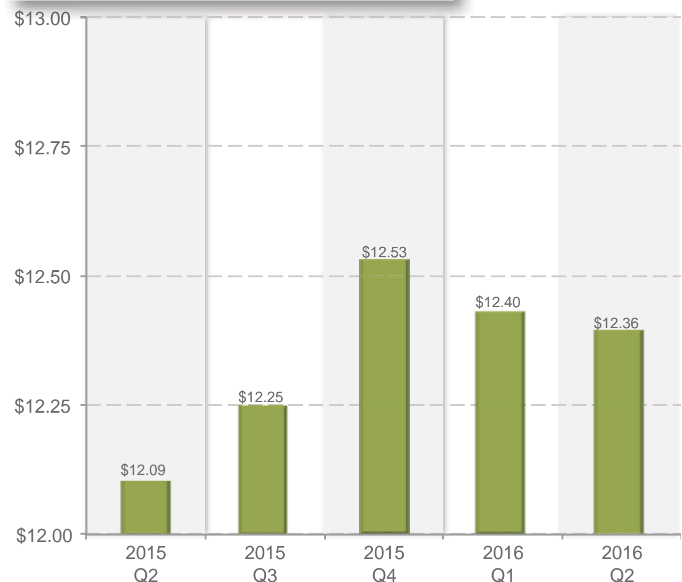
INDIANAPOLIS - TRENDING NOW (continued)

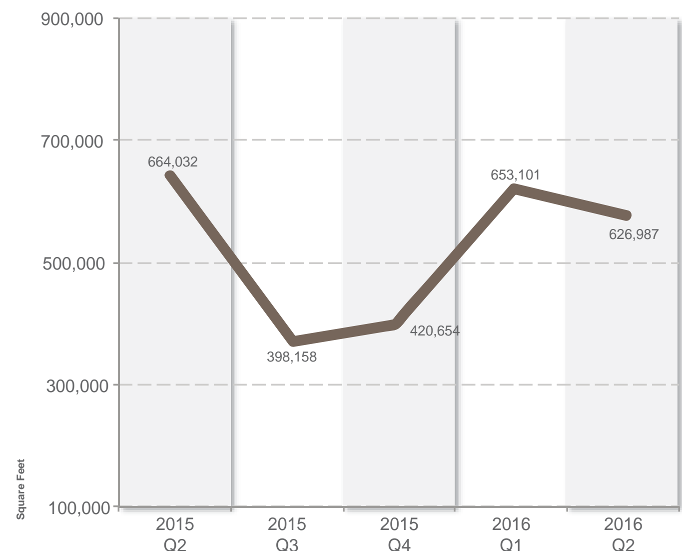
as ever, with a healthy mix of mom-and-pop and regional/national tenant demand.

Net absorption was very strong in Q2, posting a gain of 447,414 square feet in large part due to the 192,000-square foot lease to Meijer at 5550 N Keystone Ave and Costco's 148,000-square-foot deal at 4616 E County Line Road. Year-over-year gains in occupied space have been solid at 966,301 square feet. Leasing in mixed-use projects in suburban markets remains at a slow but steady pace. Structured parking is still a "new" thing for consumers, and some retailers have not fared well in those projects. Owners of these properties will need to redouble their efforts to gain acceptance of a retail trend that is sweeping the nation.

The CBD, on the other hand, is evolving beyond the restaurant/service base into a more diverse street retail tenant mix. The growing pull of "cool streets" and the growing multi-family residential market in urban neighborhoods has given rise to hot spots that just 18 months ago would have been considered fringe, the 16th Street Corridor being a prime example.

A total of 376,500 square feet of retail space was completed during the quarter, bringing total deliveries over the past four quarters to 1.1 million square feet. The largest deliveries for 2016 include the Meijer and Costco spaces, bringing the total base inventory of retail space in the Indianapolis region to nearly 124 million square feet.



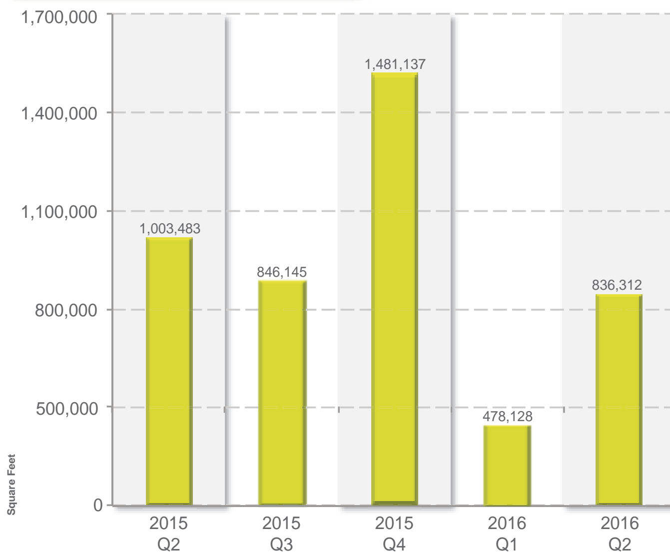


A LOOK AHEAD

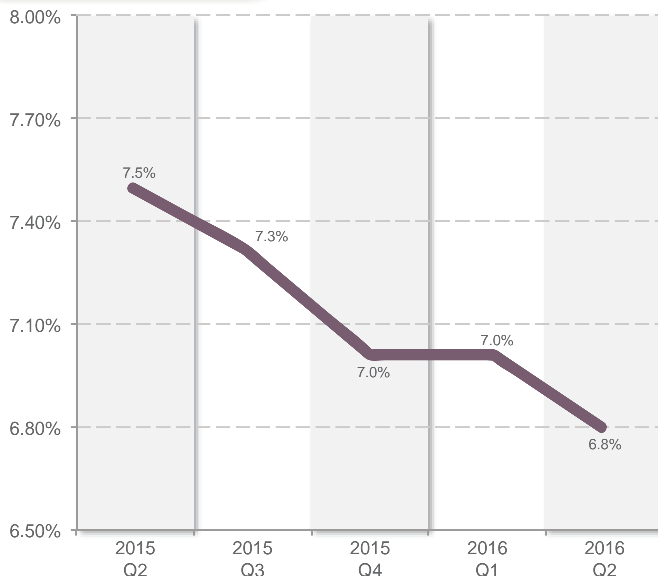
- Lease activity will remain strong for the next several quarters
- Overall vacancy will decline, but areas with functionally obsolete space will struggle to increase occupancy
- Net absorption in prime areas will be limited by lack of supply
- Asking lease rates will continue to increase, setting new records each quarter
- Spec construction activity will increase, but will be concentrated in hot submarkets
- The proliferation of "cool" streets will continue as consumers look for more of an authentic retail experience

ATLANTA

NET SF ABSORPTION



VACANCY RATE



TRENDING NOW

Strong job and population growth in the Atlanta metro area continues to attract the attention of major retailers. As in other major markets around the country, it's the urban core locations that are most compelling for retail users, as they like the density and demographic mix associated with the re-urbanization trend. Development is definitely focused on mixed-use projects, as they make the most economic sense in terms of achievable rents, but they also appeal to younger residents whose lifestyle priorities are very different from the boomer generation. They are less inclined to purchase their own residence, less likely to drive their own car and are more likely to spend their disposable income in trendy restaurants, on micro-brewed beer and in vibrant entertainment venues. The whole live-work-play phenomenon is alive and thriving in Atlanta.

Ground-up construction activity remains relatively light, but redevelopment is the name of the game. Mixed use projects like Krog Street Market, a renovated 1920's era warehouse, and the Ponce City Market, a complete renovation of the old Sears & Roebuck property, are getting all the attention. The days of building single story strip centers are over, as single use facilities just don't pencil anymore. So far this year, over 582,000 square feet of retail space has been delivered to the Atlanta market. Just under 261,000 square feet of that total came in Q2. Another 3,225,605 square feet is still being constructed. Upgrades to existing centers are ongoing. Phipps Plaza, a regional mall, is upgrading its look and adding space to accommodate retail demand for locations in higher income trade areas. However, regional centers anchored by traditional department stores are struggling to keep shop tenants that depend on the foot traffic that has been declining.

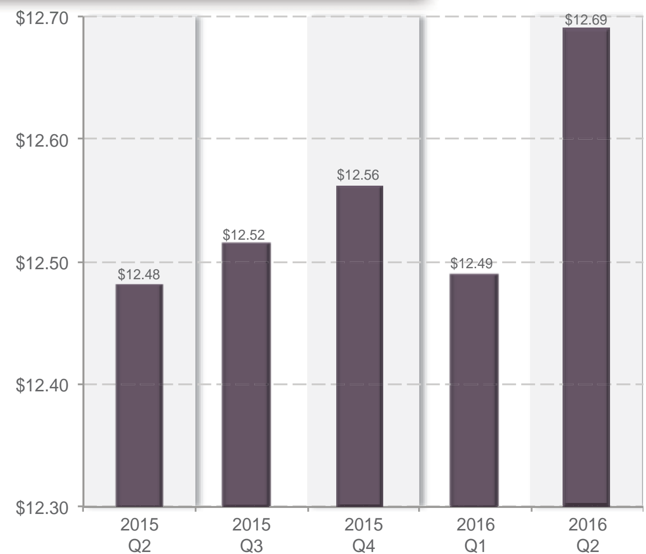
6.8%	$12.69	836,312	355,521,868	3,225,605
VACANCY	AVG. SF RENTAL RATES	NET SF ABSORPTION	RETAIL SF INVENTORY	SF UNDER CONSTRUCTION
▼	▲	▲	▼	▲

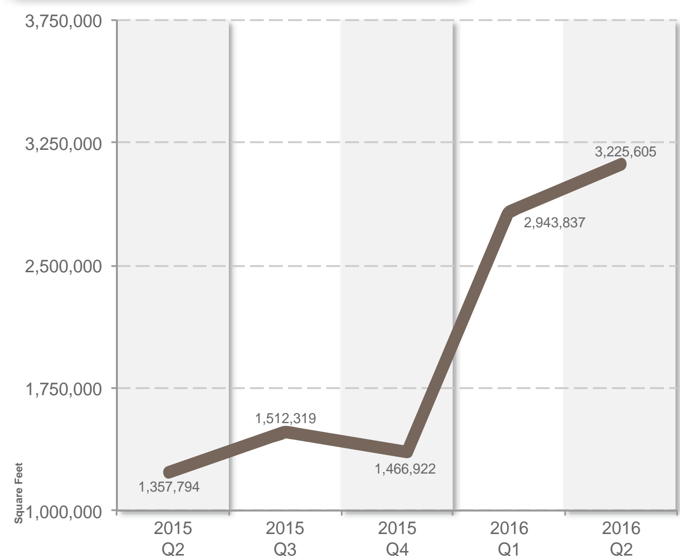
ATLANTA - TRENDING NOW (continued)

Net absorption numbers still point to a healthy retail market. The increase in occupied space for Q2 totaled 836,312 square feet, compared to 478,128 square feet in Q1 and 1,481,137 square feet back in Q4 of 2015. The biggest move-in for the quarter was the 84,146-square-foot lease to At Home at 2420 Wisteria Blvd and a Food Depot lease of 47,955 square feet at Lovejoy Station Shopping Center. The overall vacancy rate fell by 20 basis points to 6.8% in Q2. However, vacancy rates range from 4.1% to 12.5% depending on location and product type.

Asking rents also vary widely by submarket. For prime locations in urban locales like Buckhead, rates average $27.80. But, the overall average asking lease rate moved up $.20 to settle at $12.69 by the end of Q2. Trendy restaurants and entertainment venues are still willing to pay the premium for prime urban locales. Rents in those areas have spiked, while they remain relatively flat in more traditional suburban shopping centers. However, centers anchored by the most popular grocery retailers like Kroger, Publix and Whole Foods are doing well. Landlords are also pushing hard for percentage rents as a way to increase net income, while tenants are focused on protecting their sales volumes through exclusive use clauses.

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. At the other end of the retail spectrum, discount retailers like Dollar General are also in expansion mode, which is great for owners who have larger blocks of vacant space occasioned by the ongoing rescaling of major big box retailers to make them more competitive.

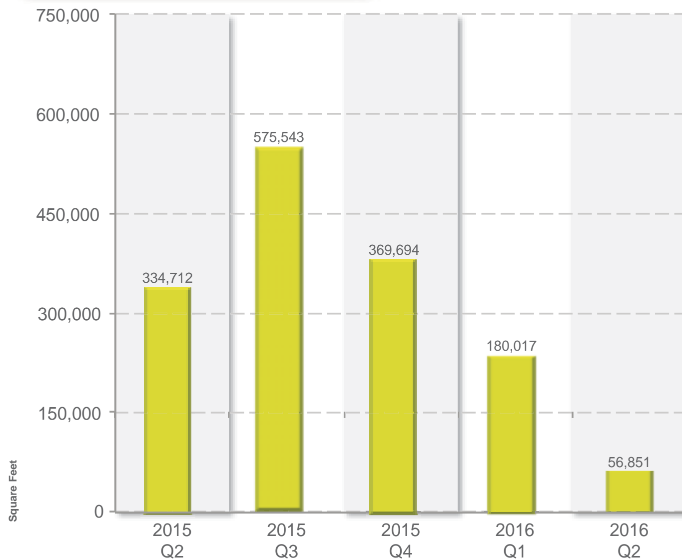


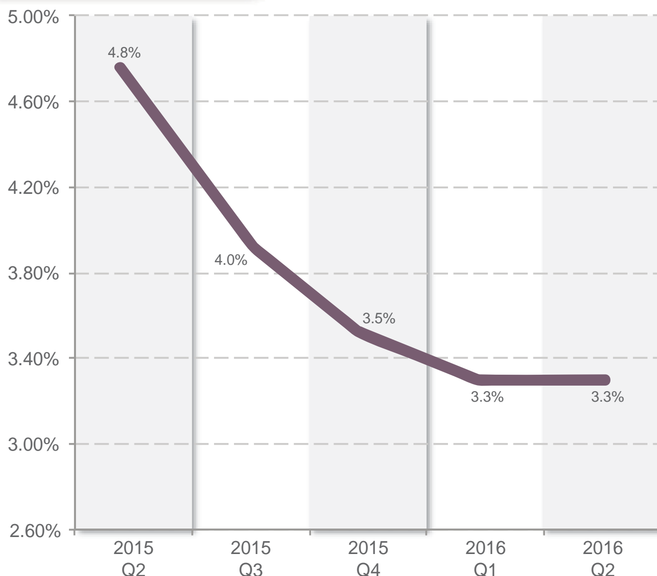


A LOOK AHEAD

- New retail concepts continue to favor more urbanized areas
- Net absorption will remain positive, but could moderate due to lack of space in prime locations
- Average asking lease rates will continue to move higher for the balance of the year
- The overall vacancy will remain near current levels, but will continue to vary widely by submarket and center type
- Developers will increase focus on redevelopment of older facilities in in-town market areas
- Ground-up retail construction will remain light

CHARLESTON





TRENDING NOW

Charleston is the oldest and second largest city in South Carolina. Its deep heritage and historic downtown area make it one of America's most visited cities. With a growing population of over 700,000 residents and one of the most active seaports on the east coast, the area has been experiencing strong economic growth, which has supported a significant expansion of the retail property market. Vacancy is declining, new construction is ongoing and older shopping centers are being upgraded and repositioned to accommodate the changes in retail demand. The region has drawn significant national attention due to recent upgrades to its deep water port and big employers choosing Charleston as their location of choice for major facilities.

Boeing's recent move and ongoing expansion has given the region a big boost, and now Volvo is under construction on a major new facility. These and other corporate relocations to the area have added thousands of good-paying full time jobs, creating more disposable income for retail spending. The Charleston Aviation Complex is leading the way. Over $13.8 billion in economic activity is generated by the combination of Boeing, the Charleston County Aviation Authority, the Charleston International Airport terminals and the U.S Air Force Joint Base Charleston. Over the past 12 months ending in May of 2016, total non-farm employment grew by 2.2% and the unemployment rate stood at just 4.2%.

The steady influx of new residents is fueling a housing shortage, which is boosting residential development throughout the region. That is providing momentum to retail development, as well. So far this year, just over 144,000 square feet of retail space has been delivered to the market and another 229,000 square feet is still

3.3%	$17.66	56,851	43,311,729	229,524
VACANCY	AVG. SF RENTAL RATES	NET SF ABSORPTION	RETAIL SF INVENTORY	SF UNDER CONSTRUCTION

CHARLESTON - TRENDING NOW
(continued)

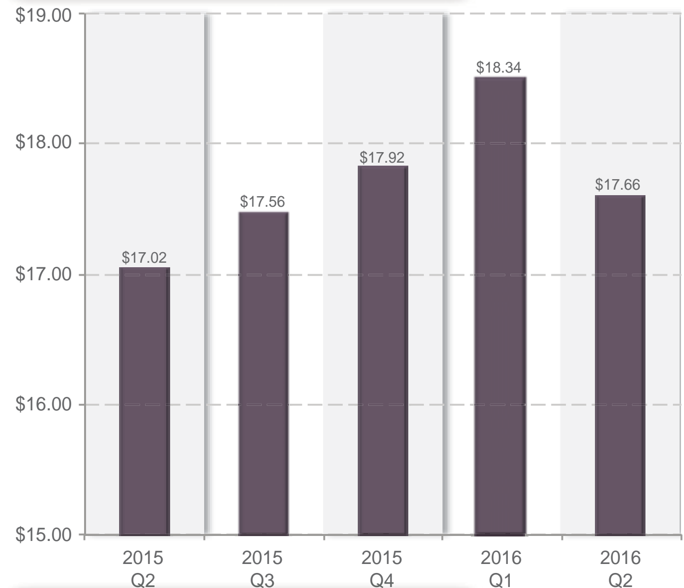
under construction. In 2015, over 503,000 square feet of new retail space was added to the base inventory, which now totals almost 43.3 million square feet.

Vacancy is tight, especially in grocery-anchored centers. In Q2, the overall vacancy rate was 3.3%, unchanged from the previous period. A year ago that rate stood at 4.8%. So, it's a good time to be a landlord and a tough time to be a tenant looking for quality retail space in prime submarkets. Lack of availability and the high barrier to entry have pushed lease rates past pre-recession levels. However, the average asking lease rate declined in Q2 to $17.66. Lease rates for new construction are starting in the low $30's range on a NNN basis, and rates on the peninsula along King Street range from a low of $40 to a high of $85 depending on location.

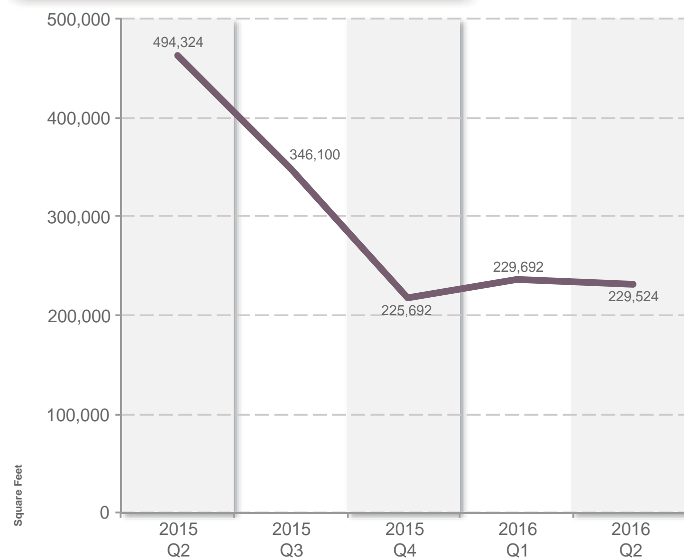
Net absorption remained positive in Q2, as well. The gain in occupied space totaled 56,851 square feet for the period, as compared to 180,017 square feet in Q1. If not for short supply in some submarkets, absorption numbers would likely be much higher.

Despite all the positive signs, developers are still having a tough time getting projects entitled and out of the ground. Municipal resistance and cries from local residents to limit growth is making the development process more cumbersome. Local assistance is crucial when navigating the approval processes that vary from one municipality to the next.

AVERAGE SF RENTAL RATES



SF UNDER CONSTRUCTION

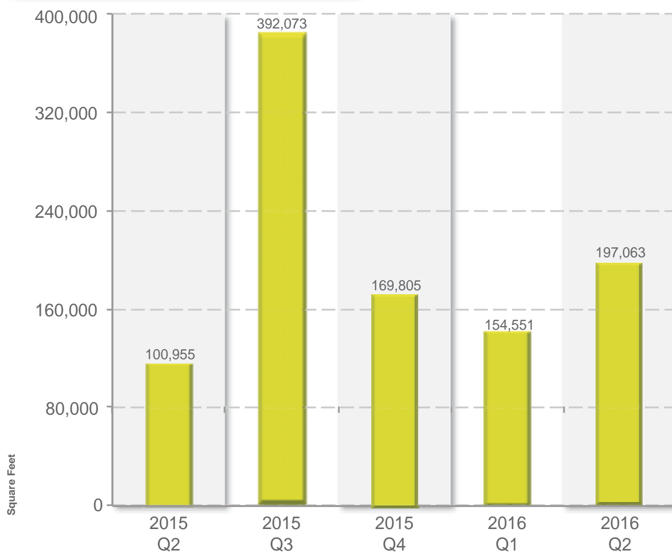


A LOOK AHEAD

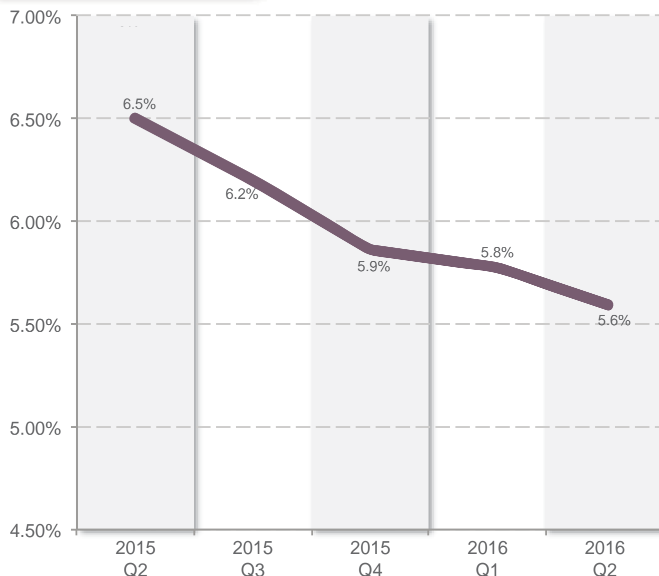
- Leasing demand will run ahead of supply throughout the region
- Vacancy will hover in the 5% range for the next several quarters
- Rent growth may top out soon as tenants may be reaching an occupancy breaking point
- Net absorption will remain positive but limited due to tightening supply
- Look for the Summerville and Mt. Pleasant areas to see the most construction activity going forward
- Cap rates for single tenant investment deals will remain compressed in the 5% range

GREENVILLE/SPARTANBURG

NET SF ABSORPTION



VACANCY RATE



TRENDING NOW

The Greenville/Spartanburg retail market has been expanding over the past several years in large part due to the relocation of major companies like BMW and Michelin to the region. Billions of dollars have been pumped into the local economy and thousands of high-paying jobs have been created, which has boosted the demand for retail space. Major corporations are attracted by the relatively low cost of living, vibrant housing market, business friendly local government, convenient airport and multiple interstate highways. The region also boasts a mild climate, exceptional healthcare, award-winning schools and recreational opportunities that gives it a reputation for offering a high quality of life to its residents.

As a result, the Greenville/Spartanburg metro area retail sector is poised for continued success as the population grows and new jobs are created. Interest from national retailers, especially grocers and restaurant chains like Cheesecake Factory, has been on the rise as the region gains national recognition. The revitalized Downtown Greenville submarket is of particular interest to retailers as its resident population is growing quickly due to multifamily housing development activity.

Vacancy has been falling throughout the region. In Q2, the overall vacancy rate fell 20 basis points to a post-recession low of 5.6%. Year-over-year vacancy has fallen by 90 basis points. Of the area's 48.6 million square feet of General Retail space, just 3.7% of it was vacant by the end of Q2. In all, there is over 85 million square feet of existing retail space in the area.

New deliveries have been light, which explains the consistent drop in vacancy. In the first half of 2016, only 98,000 square feet of new space has been delivered,

5.6%	$10.13	197,063	85,606,469	232,642
VACANCY	AVG. SF RENTAL RATES	NET SF ABSORPTION	RETAIL SF INVENTORY	SF UNDER CONSTRUCTION

GREENVILLE/SPARTANBURG - TRENDING NOW (continued)

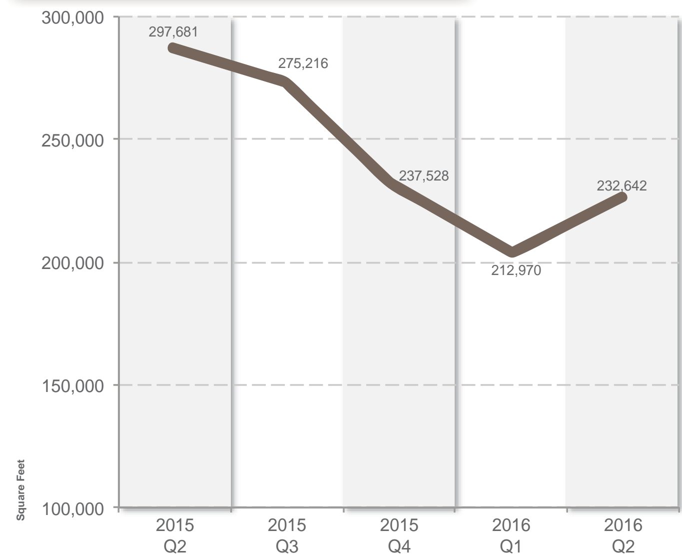
while another 232,642 square feet remained in the construction pipeline as Q2 ended. Several mixed use projects are underway and in the planning phase. Well-known bars and restaurants are being introduced to the area, including several from established brands from the Charlotte and Charleston areas.

Average asking rental rates have been making modest but consistent gains for over two years. In the second quarter, the overall asking rate increased by $.05 to finish the period at $10.13. Downtown Greenville rents are far higher, ending Q2 at $23.10. By product type, it's the power centers that lead the way on rents, posting a quoted average rate of $17. 41 at the mid-year point.

Net absorption totaled 197,063 square feet in the second quarter, after posting 154,551 square feet of net gains in Q1. In terms of submarkets, the Anderson retail area leads in absorption in 2016 with a gain of 224,003 square on a base of 13.5 million square feet. Spartanburg recorded a gain of over 120,000 square feet. Greenville gains were light for the first half of the year at just 12,369 square feet, but new construction is heaviest in that area, much of that in mixed use projects preferred by expanding retailers. Absorption throughout the region has been positive since 2010.

AVERAGE SF RENTAL RATES

SF UNDER CONSTRUCTION



A LOOK AHEAD

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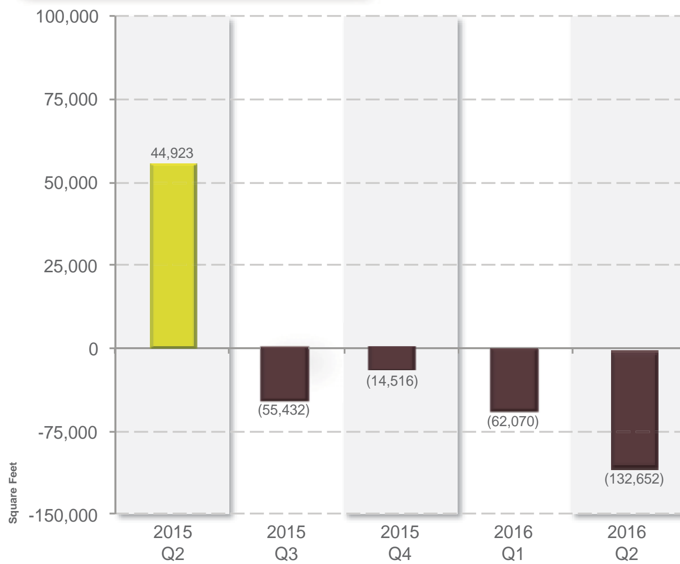
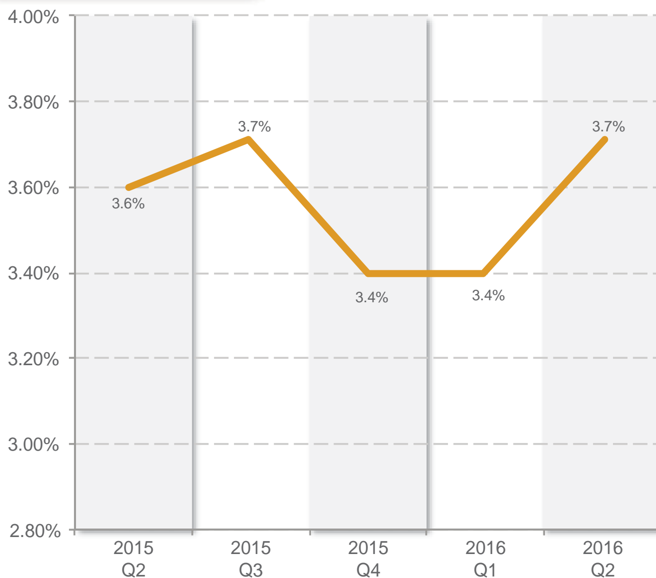
MANHATTAN

NET SF ABSORPTION



VACANCY RATE



TRENDING NOW

While Manhattan's retail market remains generally in good health, many retailers have become more cautious of late. Some are taking longer to make leasing decisions and find that they have more options to choose from. The sense of urgency has shifted, in part due to sluggish sales growth resulting from the increase in online sales. That has some retailers tapping the brakes in terms of expansion going forward.

Rent growth and leasing activity have made huge gains in recent years, especially in the high-profile office and tourist areas. Retail space in heavy tourist/business areas like Times Square, World Trade Center, Herald Square and Union Square is still in high demand, however, residential neighborhoods are seeing more vacancies, especially in properties that have recently changed ownership. New owners, who paid big premiums to acquire Manhattan real estate, are pushing hard on rents and pushing some tenants out in in the process.

Even the prime Upper East and West Side residential areas are seeing a rise in vacancy. But, it's the secondary areas and neighborhoods that are seeing a bigger falloff in demand and that has increased the pressure on landlords with empty storefronts. Outlying areas, including Brooklyn and Queens, must be added to the competitive mix, and new urban core markets in those areas offer potential opportunities at lease rates well under those in Manhattan.

Concern is also on the rise over the strength of the US dollar relative to other currencies around the world. Tourism is a huge component of retail sales growth in the region and the stronger dollar makes visiting the US more expensive in general, and in New York specifically. Despite these headwinds, luxury retailers still maintain a strong presence in Manhattan, and that has kept prime locations fully leased at record rates.

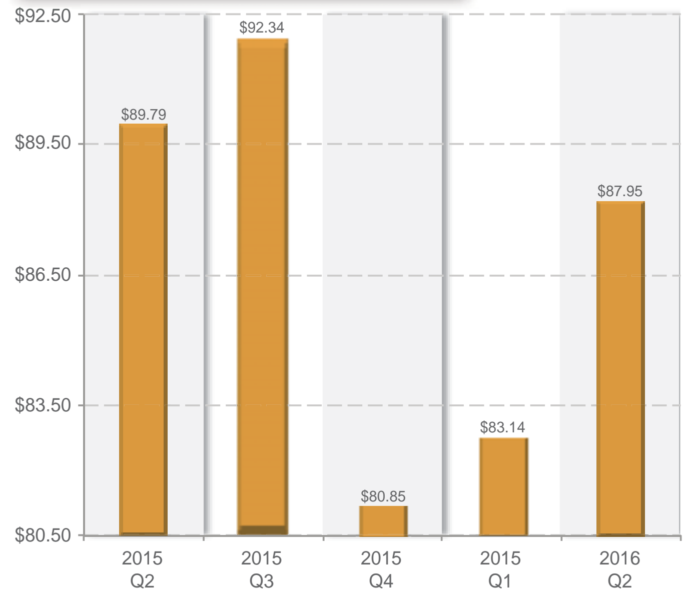
3.7%	$87.95	(132,652)	52,076,943	2,609,761
VACANCY	AVG. SF RENTAL RATES	NET SF ABSORPTION	RETAIL SF INVENTORY	SF UNDER CONSTRUCTION
▲	▲	▼	▲	▲

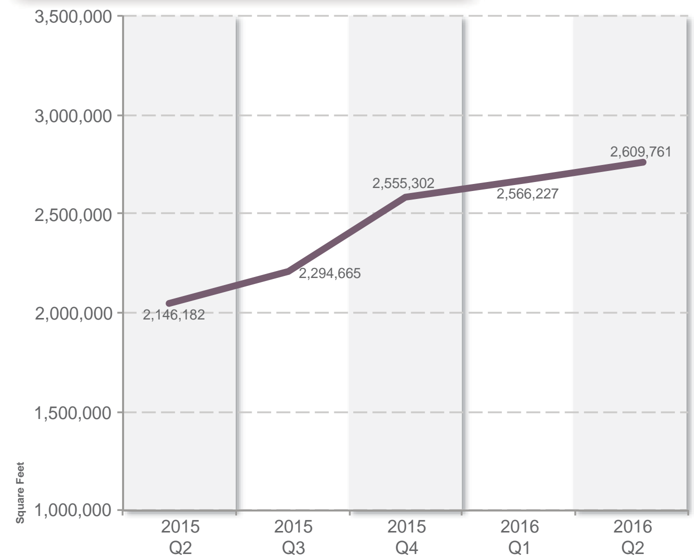
MANHATTAN - TRENDING NOW (continued)

Net absorption for the last four quarters has been slightly negative, with total occupied space declining by 264,500 square feet. Q2 accounted for half of that loss at 132,652 square feet. Significant move-ins occurred in the period to avoid a further decline. Saks Fifth Avenue moved into 86,654 square feet at Brookfield Place and Off 5th moved into 51,300 square feet at 125 E 57th Street. Newcomers to the market and small operators are still struggling with high taxes, increases in rent and higher operating costs.

The overall vacancy rate in Manhattan ticked up 30 basis points to 3.7% in the second quarter, but is unchanged year-over-year. The submarkets with the lowest vacancy is Midtown South at 2.8%, while Downtown is highest at 7%. The World Trade Center area remains 100% occupied. Local 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 under construction at Hudson Yards, World Trade Center and South Street Seaport. Those projects will command premium rents, but may take longer to lease up. In Q2, 63,226 square feet of new space was delivered in Manhattan, but another 2.6 million square feet is still under construction. 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 pose further challenges to area developers.





A LOOK AHEAD

- Vacancy will decline in prime areas, but increase in some secondary submarkets
- Asking rents will hold steady for the balance of the year
- Overall average rents will keep moving higher for the next 12-24 months, but vary widely by submarket
- Mom and Pop tenants will continue to struggle due to competitive forces
- Absorption will remain steady in primary submarkets, but lease-up time in secondary locations will rise
- Cap rates will remain compressed due to Manhattan's profile as a safe haven for foreign capital

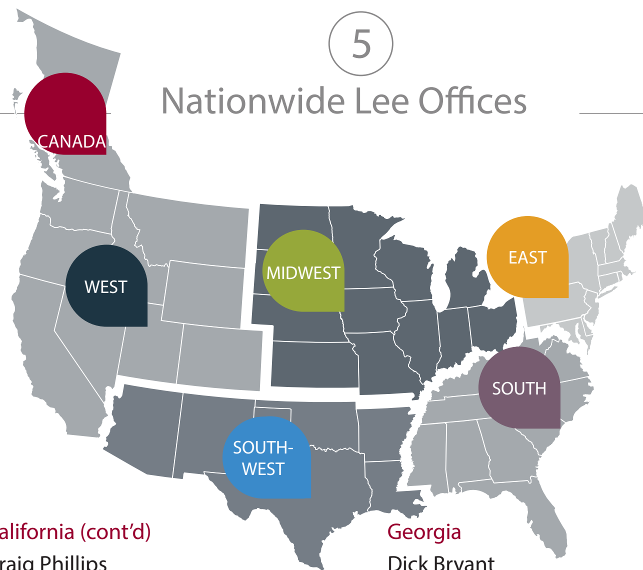
SELECT TOP RETAIL LEASES Q2 2016

BUILDING	MARKET	SF	TENANT NAME
American Dream Meadowlands	Northern NJ	180,000	Big SNOW America
11290-11584 W State Rd 84	Broward County	111,238	Lowe's
880 N. Military Hwy	Hampton Roads	90,000	Movement Mortgage
513 Broadway	San Francisco	90,000	Living Spaces
161 Washington Ave Ext	Albany/Schenectady	82,000	At Home
30-35 College Point Rd	Long Island, NY	81,532	Audi
6911 Carpenter Fire Station Rd	Raleigh/Durham	80,000	YMCA
12200 E Cornell Ave	Denver	78,000	King Soopers
631 S Post Rd	Charlotte	72,447	Nissan

SELECT TOP RETAIL SALES Q2 2016

BUILDING	MARKET	SF	PRICE PSF	CAP RATE	BUYER	SELLER
Tanger Outlet	Phoenix	34,719	$1,929.78	6.27%	Tanger Factory Outlet Centers	Ellman Companies
Suniland Shopping	Miami-Dade Cnty	82,128	$809.71	5.2%	Dividend Capital Diversified Prop Fund	Terranova Corp
76 Willoughby	Long Island	28,919	$1,611.43	4.5%	REbecca Burton Irrev Tr	Quality Capital USA
Tacoma South	Seattle	232,902	$169.17	6.8%	Retail Properties of America	Sterling Realty Org Co Prop
Bartow Marketplace	Atlanta	375,067	$92.78	7.13%	Phillips Edison Grocery Center REIT II	Inven Tr Properties Corp
New Century Commons	Palm Beach Cnty	84,551	$390.30	6.25%	Menin Development, Inc.	YS Investments

Nationwide Lee Offices



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