MARKET TRENDS | WEST COAST RETAIL

The West Coast is moving slowly on new supply and deliveries with a 40% drop from a year ago. The construction pipeline is heavy, full of projects and optimistic investors, with 8 million s.f. under construction, and vacancies are not much of a concern staying in a mid to high 4% range. Prices are at a record high and the number of lease transactions year to date is minor to say the least.

Average price per square foot has inflated to never seen highs and occupancy losses have not disrupted cash flow tremendously. Experiential design will be seen in more malls and neighborhood centers looking to increase foot traffic and get consumers spending more time at their mall. This would explain why landlords across multiple product types want more health focused tenants. According to the IHRSA (International Health, Racquet and Sportclub Association) health club members went to their respective gyms more than six billion times last year.

The proliferation of the live-work-play lifestyle is among the chief tenets redefining the direction of retail space. Many health and wellness tenants want in, taking up space – often large chunks of it – in shopping centers and malls across the country to fulfill the need. Ethnic specialty grocers are growing their footprints nationwide, evolving well beyond the basic mom-and-pop stores that originally served small communities.

Many of these stores, the bulk of them selling fresh foods familiar to foreign countries, are attracting consumers well beyond those demographics. Second and third generations now operating those markets are making them social hubs with coffee shops, food halls, and on-site mini-malls filled with non-food retailers and service providers like nail and hair salons. Non-ethnic retailers have taken notice, adding more ethnic items to their merchandise mixes. There’s a reason a store like Trader Joe’s is so popular – they sell items internationally found. Therefore, they appeal to everyone and become inclusive.

The changing of the guard in the retail industry with store closures this year, such as Dressbarn and Payless ShoeSource, make way for private investors with cash because publicly-traded real estate investment trusts are walking away from retail.

Source: CoStar, Harvard Joint Center for Housing Studies as reported by Urban Land Institute

---

<table>
<thead>
<tr>
<th>Market Breakdown</th>
<th>1H 2019</th>
<th>2H 2018</th>
<th>1H 2018</th>
<th>Annual % Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Completed Construction Units</td>
<td>2,483,255</td>
<td>4,672,482</td>
<td>4,253,912</td>
<td>-41.62%</td>
</tr>
<tr>
<td>Under Construction</td>
<td>8,191,681</td>
<td>7,322,662</td>
<td>9,533,042</td>
<td>-14.07%</td>
</tr>
<tr>
<td>Vacancy Rate</td>
<td>4.70%</td>
<td>4.50%</td>
<td>4.70%</td>
<td>0.00%</td>
</tr>
<tr>
<td>Availability Rate</td>
<td>6.00%</td>
<td>5.90%</td>
<td>6.00%</td>
<td>0.00%</td>
</tr>
<tr>
<td>Asking Lease Rate</td>
<td>$25.32</td>
<td>$24.46</td>
<td>$23.86</td>
<td>6.12%</td>
</tr>
<tr>
<td>Lease Transactions</td>
<td>15,236,394</td>
<td>1,888,509</td>
<td>21,665,516</td>
<td>-29.67%</td>
</tr>
<tr>
<td>Average Sale Price (SF)</td>
<td>$321.95</td>
<td>$264.22</td>
<td>$282.85</td>
<td>13.82%</td>
</tr>
<tr>
<td>Net Absorption</td>
<td>-342,327</td>
<td>7,169,294</td>
<td>3,963,655</td>
<td>N/A</td>
</tr>
</tbody>
</table>
Seattle

- 1.36M SF UNDER CONSTRUCTION
- ▼ 3.3% VACANCY
- ▼ 500,328 SF NET ABSORPTION
- ▼ $24.11 ASKING LEASE RATE

Vacancy is at its lowest level in more than 10 years. Recent demand is strong with absorption reaching more than 400,000 SF in the first half of the year. Tight vacancies are aided by a modest delivery schedule, especially compared with last cycle. Grocers, restaurants, and discount retailers account for a large portion of absorption over the past few years. While the metro is performing well, there are some causes for concern in the mall space. Store closures by the likes of JCPenney, Kmart, Sears, Nordstrom, are causing concerns for brick and mortar business models. Many malls are repositioning to create an “experiential” environment. Playgrounds, live concerts, DIY activities (do-it-yourself) are all a part of the experiential model.

READ FULL REPORT

Portland

- 380,421 SF UNDER CONSTRUCTION
- ▼ 3.3% VACANCY
- ▼ $19.57 ASKING LEASE RATE

Portland’s retail industry is anchored by its strong economic fuelers: highly unusual population growth, vigorous job gains, and the exorbitant median household income. Sales tax does not exist in Oregon. The savings consumers reap allow more spending on retail goods, therefore, giving the economy a boost. Absorption was negative in Q2 2019 due to multiple tenants moving out of spaces under 30,000 s.f. Retail absorption in the suburbs continues to pick up the pace. Big Lots, Wilco, Hobby Lobby, and Ashley Home Furniture signed leases in Q2 2019. Retail sales are secure, but online sales could impair demand for brick-and-mortar locations, especially in a metro that is expanding tech presence.

READ FULL REPORT

Oakland/East Bay

- 63,488 SF UNDER CONSTRUCTION
- ▲ 3.5% VACANCY
- ▼ $27.31 ASKING LEASE RATE

East Bay is home to one of the healthier retail markets in the country. Vacancies remain tight, rivaling those in premier coastal markets like San Francisco and Boston, and relatively limited new construction averts concern about a major vacancy expansion happening any time soon. While rents were especially slow to recover from the recession, gains have been strong over the last few years. Despite rent growth beginning to slow in 2016, East Bay in 2017 and 2018 has seen rent growth continue to outpace neighbor San Francisco. Institutional and regional investors alike continue to show interest in this metro, and investment volume this cycle has far surpassed that of the previous cycle.

READ FULL REPORT

San Francisco/Peninsula

- 166,255 SF UNDER CONSTRUCTION
- ▼ 2.6% VACANCY
- ▼ 95,769 SF NET ABSORPTION
- ▼ $42.63 ASKING LEASE RATE

San Francisco has maintained tighter retail vacancy rates than most other core, supply-constrained markets, such as Boston and New York. It is a perennially under supplied retail market. Big box retailers including Macy’s and Best Buy have shed large blocks of space and will close additional stores in San Francisco and throughout the Bay Area in 2019 and beyond, due to flagging sales. The tech industry continues to power above-average employment and income growth here, which has, in turn, continued to attract investors to the metro. Although rents are extremely high, rent growth has slowed significantly. The year ended with growth at less than half a percent. Recent demand has been fueled by experimental retail projects, trendy fitness and health boutiques, and expansion of click-to-bricks retailers.

READ FULL REPORT

Silicon Valley

- 977,335 SF UNDER CONSTRUCTION
- ▼ 3.6% VACANCY
- ▼ $33.84 ASKING LEASE RATE

A miniscule amount of new buildings and historically small vacancy rates have helped sustain the San Jose retail market, while many other retail markets have struggled in recent years. Construction holds steady despite tight fundamentals. Even with vacancy in the mid-single digits, supply underway represents less than 2% of the existing inventory base, with 977,335 SF currently under construction. Most developers able to build today are focused on apartment or office projects as demand and community support favor these property types. Lucrative, stable tech companies are the lifeline. Rising start-ups have abundant cash on hand and require large spaces and unique renovations. This boost continues to prompt real estate expansions and job gains.

READ FULL REPORT

Sacramento

- 226,468 SF UNDER CONSTRUCTION
- ▲ 6.3% VACANCY
- ▼ $16.08 ASKING LEASE RATE

Considering its proximity to major distribution hubs like East Bay and Reno, the Sacramento market typically depends on demand from local and regional tenants. Thanks to exceptionally strong demand throughout the current cycle, retail vacancies have compressed significantly. Construction has been steady—albeit limited in scope—but 2018 emerged as easily the strongest year of the cycle for new deliveries. Sacramento’s average rents, just a fraction of those in the Bay Area, have seen growth pullback after several years of strong returns, but gains continue to outpace the tepid long-term average. Investment reached a new high in 2018, with more than $900 million of transactions.

READ FULL REPORT
### Reno

- **68,636 SF** UNDER CONSTRUCTION
- **9,406 SF** NET ABSORPTION
- **$14.28** ASKING LEASE RATE

Since 2014, the local sales market has notably outperformed the metro’s historical average. Due to job growth and competitive earnings, purchase power is robust. However, investment volume in 2019 is well below the recent norm. Malls and power centers, with asking rents more than 10% above South Reno’s overall retail average, account for about 35% of total retail inventory in the submarket. Although Sacramento’s power centers are exhibiting strength, no category is immune to store closings. South Reno is one of the more populated locales here and vacancy is about on par with the metro average. WeWork signed the year’s largest lease in Sacramento. Sacramento is realizing the experiential conversion many centers are undergoing to save revenue losses due to negative absorption.

### Los Angeles

- **2.30M SF** UNDER CONSTRUCTION
- **-1.14M SF** NET ABSORPTION
- **$19.08** ASKING LEASE RATE

Los Angeles retail per capita stock is attractive to long term investors. For example, Los Angeles only has 3% more total retail square footage than Dallas-Fort Worth, despite the metro having 58% more people than D-FW. Delivering new development is difficult in growing metros like Los Angeles even if land is available. This embedded supply constraint is attractive to long-term investors. On the other hand, some investors find financial performance at the mall stores are down because shopping malls have seen foot traffic decline and empty out. Also, the cost of staying in the mall is higher than being elsewhere. Malls and other retail centers are focusing on tricks to lure consumers, from getting kids to make repeat visits to setting up pop-up spaces for short-term stores to keep drawing customers.

### Orange County

- **95,967 SF** UNDER CONSTRUCTION
- **-162,854 SF** NET ABSORPTION
- **$27.60** ASKING LEASE RATE

The retail sector in Orange County, California, has recorded the slowest rent growth of all property types this cycle. Averaging only 1.5% in rolling 12-month rent growth since 2010, this trails office at 2.5%, multifamily at 2.8% and industrial 4.1% in annual rent growth. Orange County is a prime tourist destination and remains one of the top 10 most expensive markets. Moreover, Orange County is home to several world-class malls, from South Coast Plaza to Fashion Island, where vacancy and rental rates will always be favorable to the landlords. Developers continue to focus their efforts on transforming vacant anchor space, not ground-up development, to appeal to shoppers.

### Inland Empire

- **1.09M SF** UNDER CONSTRUCTION
- **$19.08** ASKING LEASE RATE

In line with local demand, roughly 40% of retail inventory is in neighborhood centers, compared to 26% nationally. A few exceptions are the metro’s various outlet centers, including Ontario Mills, the Cabazon Outlets, and the Outlets at Lake Elsinore. Leasing by fitness gyms has also become a growing trend. Planet Fitness opened in Rialto in December 2018, while Chuze Fitness has leased space in San Bernardino and Blink Fitness has leased space in Rialto with future move in dates. With respect to other vacancies, within the next five years projections show an increase to around 7.7%—about 20 basis points below the metro’s average since 2006. The highest gains can be seen in the most trafficked regions. West San Bernardino, Riverside, and Airport Area rents grew the most from 2Q 2018 and 2Q 2019.

### San Diego

- **462,406 SF** UNDER CONSTRUCTION
- **$22.56** ASKING LEASE RATE

San Diego is a worldwide tourist destination. As such, tourists pour billions of dollars into the local economy. Among all asset classes, retail sales have proven to be the steadiest over the past few years. Transaction volume is consistent, and in 2019, that trend has continued. In fact, San Diego recorded one of the largest suburban retail sales in years in 2Q19, the $150 million deal for Clairemont Town Square. Like most metros, store closures have hit here in the past few years. Finding 100,000-SF anchor tenants can be challenging. Some landlords are turning to restaurants, while others are breaking the space into smaller floor plans that can accommodate several tenants. Both local and institutional money are active here, and most money comes from within California.

### Phoenix

- **1.00M SF** UNDER CONSTRUCTION
- **$16.20** ASKING LEASE RATE

Deliveries are up, construction is mild, absorption is positive, and vacancies are down. Rents have ticked up slightly and sales price hovers over $213 per square foot. Plenty of investors are coming from outside of the state, particularly California, to find above-average yields late in the cycle. Ecommerce and evolving buying patterns have led to the repositioning of many subpar shopping malls and centers. For example, the once-thriving Fiesta Mall in Mesa sat largely vacant for years but was acquired last year by foreclosure. Plans are underway for the redevelopment of the mall into office space for health and education tenants. Phoenix only has about 47 SF of retail space per capita, which is below the national average and one of the lowest concentrations of retail space among major metros in the Southwest.
Kidder Mathews is the largest, independent commercial real estate firm on the West Coast, with 800 real estate professionals and staff in 22 offices in Washington, Oregon, California, Nevada, and Arizona. We offer a complete range of brokerage, appraisal, property management, consulting, project and construction management, and debt equity finance services for all property types.

### ANNUAL NEW CONSTRUCTION & CAP RATES

<table>
<thead>
<tr>
<th>Year</th>
<th>300K</th>
<th>600K</th>
<th>900K</th>
<th>12M</th>
<th>15M</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009</td>
<td>5%</td>
<td>6%</td>
<td>7%</td>
<td>8%</td>
<td>9%</td>
</tr>
<tr>
<td>2010</td>
<td>5%</td>
<td>6%</td>
<td>7%</td>
<td>8%</td>
<td>9%</td>
</tr>
<tr>
<td>2011</td>
<td>5%</td>
<td>6%</td>
<td>7%</td>
<td>8%</td>
<td>9%</td>
</tr>
<tr>
<td>2012</td>
<td>5%</td>
<td>6%</td>
<td>7%</td>
<td>8%</td>
<td>9%</td>
</tr>
<tr>
<td>2013</td>
<td>5%</td>
<td>6%</td>
<td>7%</td>
<td>8%</td>
<td>9%</td>
</tr>
<tr>
<td>2014</td>
<td>5%</td>
<td>6%</td>
<td>7%</td>
<td>8%</td>
<td>9%</td>
</tr>
<tr>
<td>2015</td>
<td>5%</td>
<td>6%</td>
<td>7%</td>
<td>8%</td>
<td>9%</td>
</tr>
<tr>
<td>2016</td>
<td>5%</td>
<td>6%</td>
<td>7%</td>
<td>8%</td>
<td>9%</td>
</tr>
<tr>
<td>2017</td>
<td>5%</td>
<td>6%</td>
<td>7%</td>
<td>8%</td>
<td>9%</td>
</tr>
<tr>
<td>2018</td>
<td>5%</td>
<td>6%</td>
<td>7%</td>
<td>8%</td>
<td>9%</td>
</tr>
</tbody>
</table>

### COMMERICAL BROKERAGE

- **400+** NO. OF BROKERS
- **$9B** ANNUAL TRANSACTION VOLUME
- **20M** ANNUAL SALES SF
- **40M** ANNUAL LEASING SF

### VALUATION ADVISORY

- **1,600+** APPRAISALS ANNUALLY
- **36/24** TOTAL NO. APPRAISERS/MAI’S

### PROPERTY MANAGEMENT

- **60M+** MANAGEMENT PORTFOLIO SF

The information in this report was composed by the Kidder Mathews Research Group.

**JERRY HOLDNER**

Director of Research
949.557.5050
jerry.holdner@kidder.com
LIC N° 01145748

**KIDDER.COM**

This information supplied herein is from sources we deem reliable. It is provided without any representation, warranty or guarantee, expressed or implied as to its accuracy. Prospective Buyer or Tenant should conduct an independent investigation and verification of all matters deemed to be material, including, but not limited to, statements of income and expenses. CONSULT YOUR ATTORNEY, ACCOUNTANT, OR OTHER PROFESSIONAL ADVISOR.