Retail Performance Buoyed by Accelerating Economy; Vacancies Tumble Amid Limited Construction

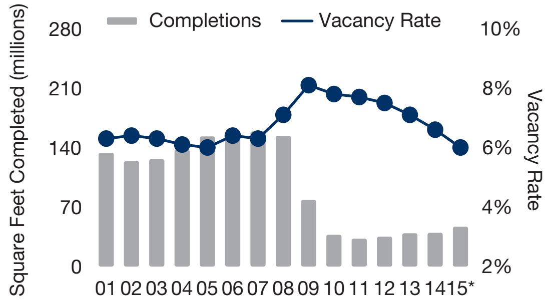
The accelerating U.S. economy, together with stronger hiring and income growth, has lifted consumer confidence and supported increased spending. This in turn has pulled an increasing number of retailers from the sidelines. Anemic supply growth concurrent with a 26 percent increase in absorption netted a 50-basis-point decrease in vacancy to 6.6 percent, the largest decline in 14 years. The level of energy, competition and rapidity of change in the retail industry has accelerated as new concepts, expanded distribution channels, and engaged international brands to challenge outdated market strategies and uninspired store formats. Location is the retailer mantra and the scarcity of quality chain retail space has resulted in creative redevelopment of select urban storefronts for luxury retailers. Vacant anchor space in malls and shopping centers has found new larger-format tenants such as Forever 21 or Whole Foods, while reconfigured in-line and end-cap spaces have drawn high demand from restaurants, fitness centers, specialty grocers and entertainment venues. Repurposing of otherwise functionally obsolete but well-located buildings for uses such as medical offices or charter schools has also bolstered performance trends.

Exceptional investor demand for urban storefront and single-tenant product mirrors the strength and direction of retailer demand for these property types, which is ultimately shaped by demographic, societal and technology trends. The millennial generation has fostered strong growth in casual dining brands such as Chipotle, Panera Bread and Baja Fresh, as well as spinoffs of traditional retailers targeting a younger audience by locating in core submarkets in urban storefront formats. Single-tenant properties accounted for more than two-thirds of retail absorption and 76 percent of last year's meager completions. The vacancy rate now matches a pre-recession low of 5.8 percent. Although recovery in multi-tenant product thus far has lagged that of single-tenant, net absorption increased by 52 percent over the prior year and vacancy fell to 8.0 percent from 8.5 percent. At $18.68 per square foot, the average asking rent for single-tenant properties remains 8.1 percent below peak, while the average for multi-tenant properties, at $16.64, lags peak rents by 12.0 percent.

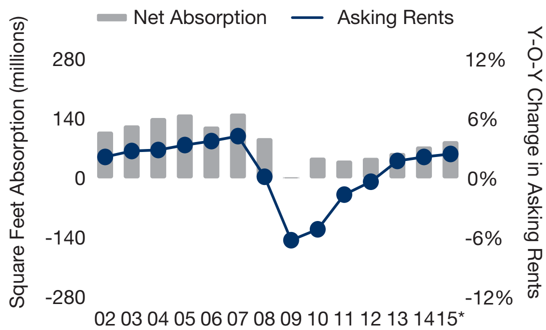
2015 Investment Outlook

- **Space Fundamentals Remain on Positive Trajectory:** Retailers absorbed nearly 75 million square feet in 2014, eclipsing the nearly 40 million square feet of new space delivered and resulting in a 2.2 percent gain in asking rents. This positive dynamic is forecast to carry into 2015, with net absorption of nearly 88 million square feet readily outpacing modest additions to supply of 47 million square feet. Vacancy should further decline to 6.0 percent, pushing rent gains of 2.5 percent.
- **Landlords Redevelop Existing Centers and Incorporate Mixed Uses:** Increasingly abundant capital enabled developers to strategically introduce new concepts in retail and entertainment, while e-retailers such as Amazon may test new sales formats, such as brick-and-mortar stores.
- **Housing Recovery Reboot:** Congress and lenders will develop reasonable new guidelines to facilitate a quicker return to credit-worthiness for potential homebuyers still on the financial mend. Retailers will follow new housing development in dynamic employment and population centers, prompting higher levels of retail construction.

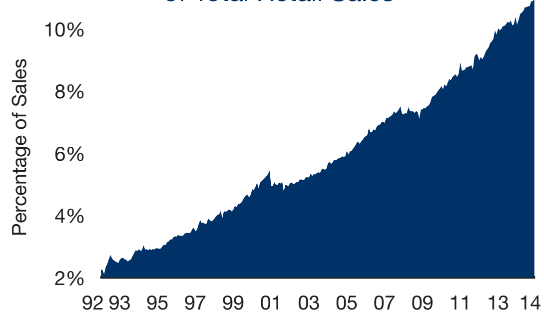
Retail Construction and Vacancy



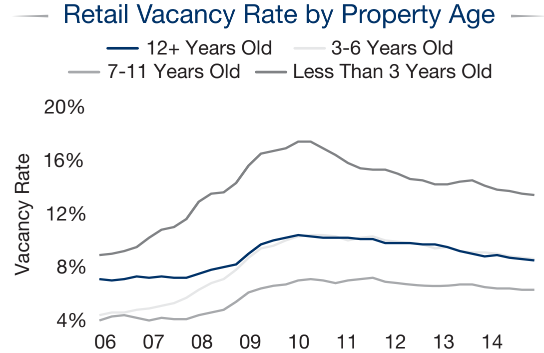
Net Absorption vs. Asking Rents



Internet Sales as a Percent of Total Retail Sales



Retail Vacancy Rate by Property Age



Includes all multi-tenant shopping centers 10,000 square feet and larger

* Forecast