

GREATER PHOENIX | RETAIL

2Q 2015

Accelerating success.

Retail Expansion Slowed to a Modest Pace in the First Half

Key Takeaways

- › Retail vacancy in Greater Phoenix ended the second quarter at 10 percent. While the rate is lower than it was one year ago, there has been minimal improvement recorded thus far in 2015.
- › Net absorption has been positive, but the pace has been slower than in recent years. In the first half of 2015, net absorption totaled less than 550,000 square feet.
- › Rent trends have been mixed. Asking rents have been on the decline for several years, and current rents are lower than year-earlier levels. Thus far in 2015, however, asking rents have ticked higher, but it is too early to tell if this is a reversal of the prevailing long-term trend.
- › Sales of shopping centers slowed in the second quarter, but prices pushed higher. A few more quarters of strengthening market fundamentals would likely support additional investment activity.

Greater Phoenix Retail Market

The Greater Phoenix retail market has recorded some improvement in the first half of 2015, with vacancy dipping slightly in response to a modest total of positive net absorption. While net absorption has been positive thus far in 2015, the pace has lagged levels recorded in recent years. In the first half of this year, net absorption totaled less than 550,000 square feet, compared to an average of nearly 1 million square feet in the first halves of the years from 2012-2014. Net tenant demand will remain positive in the second half as the overall vacancy rate is forecast to dip below 10 percent by year end, which will serve as a noteworthy milestone after the rate was in double digits for more than five straight years.

Market Indicators Relative to prior period	Market Q2 2015	Market Q2 2014
Vacancy	↔	↓
Net Absorption	↓	↑
Construction	↓	↑
Rental Rate	↑	↑

Second Quarter Employment Trends*

Total Nonfarm Phoenix Metro	↓	↑
Total Nonfarm United States	↑	↑

*Source: Bureau of Labor Statistics

Summary Statistics	Phoenix Market
Vacancy Rate	10.0%
Change from 2Q 2014 (bps)	-70
Net Absorption (thousands SF)	257
New Construction (thousands SF)	139
Under Construction (thousands SF)	410
Asking Rents Per Square Foot Per Year	\$13.41
Change from 2Q 2014	-3.0%

Greater Phoenix Retail Market (continued)

The one market indicator that could serve as a barometer of the retail market in the coming quarters is the rental rate. Over the past several years, rents have fallen as vacancy has been elevated and leasing activity has been modest. As the local economy has improved and tenants have expanded into previously vacant spaces, local asking rents have stabilized somewhat. Thus far in 2015, asking rents have

ticked higher on average, but there has not been any significant momentum recorded to this point in the cycle. Further vacancy declines could be the trigger for more sustained rent increases, particularly if employers continue to expand payrolls and the economy strengthens at both the national and local levels.

Recent Transactions in the Market

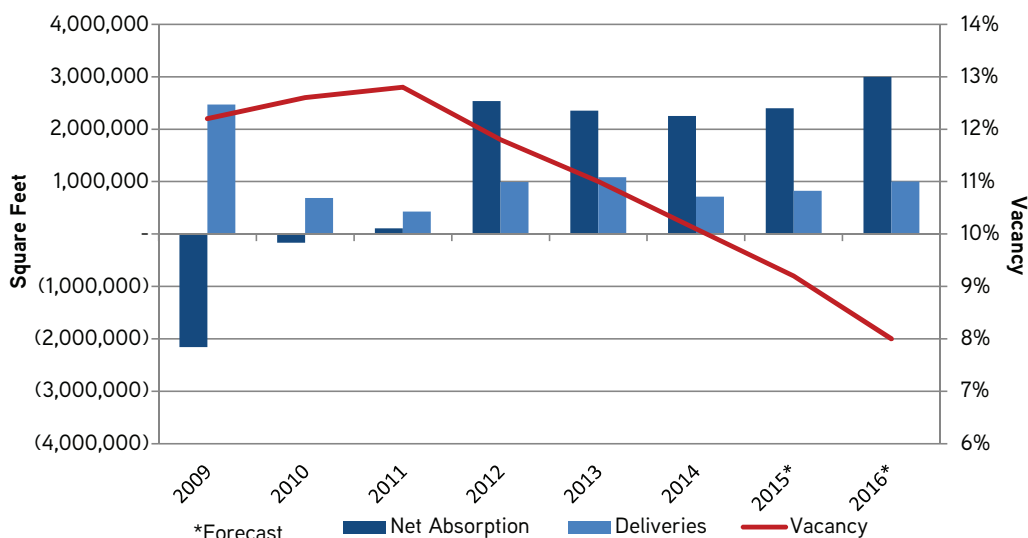
RETAIL SALE ACTIVITY

Property Address	Submarket	Sale Date	Sale Price	Size SF	Sale Price SF
32331-32687 N Scottsdale Rd., Scottsdale	North Scottsdale	6/30	\$54,100,000	190,408	\$284
466 - 1168 S Watson Rd., Buckeye	West Phoenix	5/6	\$40,000,000	186,355	\$215
7306 - 7388 E Shea Blvd., Scottsdale	Scottsdale	6/5	\$32,500,000	115,189	\$282
15090 N Northsight Blvd., Scottsdale	North Scottsdale	4/21	\$11,600,000	88,031	\$132
6990 E Shea Blvd., Scottsdale	Scottsdale	4/16	\$10,580,000	48,669	\$217

RETAIL LEASE ACTIVITY

Property Address	Submarket	Tenant	Size SF
1050 E Pecos Road, Chandler	East Valley	Kids That Rip Indoor Skatepark	54,375
9001-9175 E Indian Bend Road, Scottsdale	Scottsdale	Frontgate Outlet Store	32,590
13802 N Scottsdale Road, Scottsdale	North Scottsdale	Natural Grocers	27,827
34750 N North Valley Parkway, Phoenix	Northwest Phoenix	DownEast Outfitters	20,388

Historical Absorption, Deliveries and Vacancy Rates



Vacancy:

- > Vacancy in the Greater Phoenix retail market ended the second quarter at 10 percent, 70 basis points lower than one year earlier, but identical to the first quarter rate. Local vacancy has been slowly trending lower as the economy improves, but rapid declines have yet to materialize due to the presence of numerous vacant big-box spaces.
- > More than 30 percent of all vacant retail space in Greater Phoenix is located in the East Valley submarket cluster than includes the cities of Chandler, Gilbert, Tempe and Mesa. Vacancy in the East Valley ended the second quarter at 10.9 percent, 150 basis points lower than one year ago. Vacancy in the East Valley peaked at 15 percent in 2011, and has since declined as tenants have moved into a net of more than 3 million square feet.
- > The Northwest Phoenix submarket cluster, which includes Peoria, Deer Valley and Surprise, has had one of the lowest vacancy rates in the Greater Phoenix retail market in recent years. Vacancy in the Northwest Phoenix area ended the second quarter at just 6.1 percent, down from 6.9 percent one year earlier.

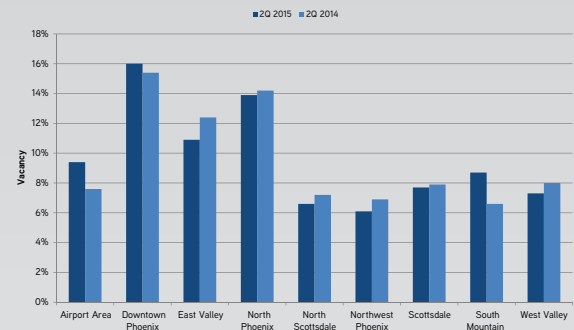
Rents:

- > Rent trends have been uneven in recent months. Year over year, average asking rents have declined 3 percent to \$13.41 per square foot. Thus far in 2015, however, asking rents have actually ticked up a fraction.
- > One area where landlords are achieving rent increases is the Downtown Phoenix area, where asking rents have increased 4.1 percent to \$13.93 per square foot thus far in 2015. While Downtown Phoenix is a fairly small retail submarket, the area is being boosted by a growing residential population as well as an influx of businesses coming into the area.
- > Asking rents in the East Valley appear to have largely stabilized, dipping 1.5 percent in the past 12 months and retreating a modest 0.5 percent thus far in 2015 to \$12.75 per square foot. While elevated vacancies in the East Valley will make it difficult to implement rent gains in the near future, a stabilization of the rate would help to identify the market bottom.

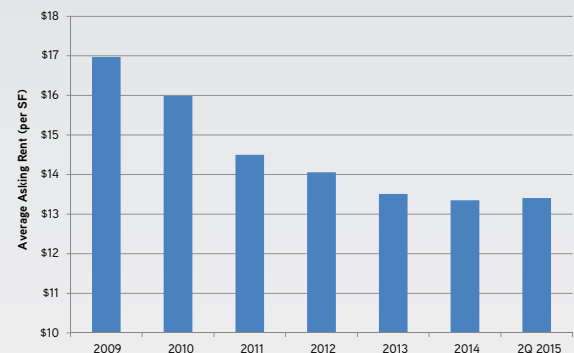
Investment Trends:

- > Sales of shopping centers slowed approximately 30 percent from the first quarter to the second quarter. Even after accounting for the drop in activity recorded over the past few months, sales velocity for local shopping centers in the first half of 2015 outpaced the first half total from last year by 14 percent.
- > The median sales price reached \$133 per square foot in second quarter deals, up from \$90 per square foot in the first quarter. Year to date, the median price has been \$106 per square foot, a 7 percent dip from the 2014 median.
- > Average shopping center cap rates are approximately 7.7 percent thus far in 2015, a tick higher than the average in 2014. Cap rates are expected to remain near current ranges until clearer signs of market stabilization and rent increases emerge.

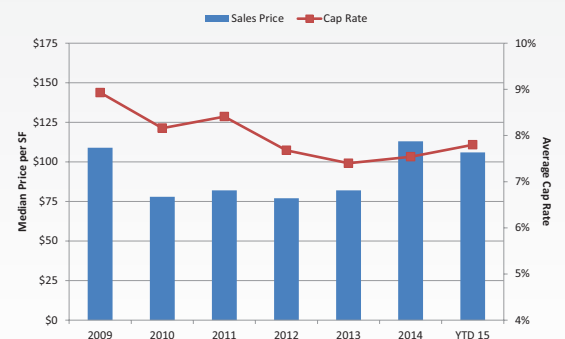
Vacancy by Submarket Cluster



Asking Rents Trends



Investment Trends



Outlook:

The Greater Phoenix retail market is forecast to maintain its slow improvement cycle, with absorption positive and vacancy trending lower. There is still an overhang of existing vacant space, however, and new development is being limited almost exclusively to smaller infill projects in high-traffic locations. This trend is expected to persist, particularly if the local housing

market remains stuck in neutral. While new home construction has bounced off cyclical lows, with single-family permitting up more than 25 percent in 2015 from year-earlier totals, levels remain much lower than historical averages. Further acceleration in the new-home market could ultimately lead to additional retail development.

FOR MORE INFORMATION

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