Retail First Glance

2015
Quarter 1

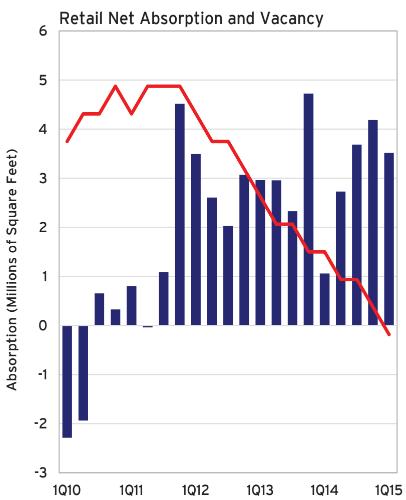
Pre-Release Analysis of First Quarter 2015 Reis Findings in the Retail Sector

Ryan Severino, CFA
Senior Economist

New York – April 15, 2015

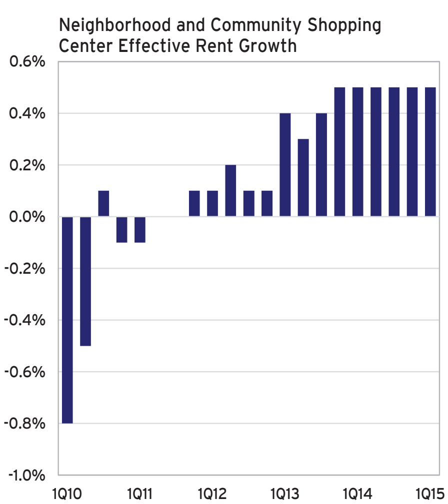
Steady As She Goes

Neighborhood and community center shopping vacancy declined by 10 basis points during the first quarter to 10.1%. Although the pace of quarterly vacancy compression has not yet accelerated, declines in the national vacancy rate are becoming more consistent on a quarterly basis. Over the last 12 months, the national vacancy rate declined by 30 basis points, which matches the best performance over a 12-month interval since the recovery for retail began in the latter half of 2011. The national vacancy rate has declined by 100 basis points from its historical peak during the third quarter of 2011. This is the slowest rate of vacancy compression during a recovery from a recession since Reis began tracking the market in 1980.



Neither new construction nor net absorption were robust during the quarter, in line with recent performance. New completions totaled just 1,962,000 SF while occupied stock increased by 3,516,000. The appetite for new construction of neighborhood and community centers remains meager, owing partially to restrictive lending standards and partially to sheer lack of demand for the subsector.

Yet, while the relatively weak economic recovery is not helping, there is more at work than simply that. Labor markets surpassed previous peak levels while consumer spending has also attained new heights. Normally this would signal a stronger performance from neighborhood and community centers, certainly on the demand side of the ledger. However, the rise of alternative retail formats has clearly siphoned interest away from neighborhood and community centers. In addition to ecommerce, this proliferation of the diversity of retail formats has likely permanently changed the landscape for retail.



Asking and effective rents both grew by 0.5% this quarter, which was more or less in line with the previous quarter. Over the last 12 months, asking and effective rents grew by 1.9% and 2.0%, respectively. This is on par with the prior 12-month period. Rent growth will continue to struggle while vacancy remains elevated and with the pace of vacancy compression unlikely to change in the near term, there should not be much, if any, acceleration in rental growth.

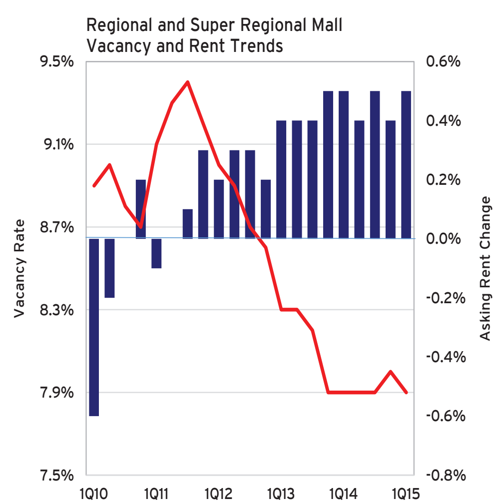
First Quarter 2015 Market Performance
Improving Fundamentals / Flat or Declining Fundamentals

	Absorption	Occupancy	Effective Rent
Q1 2015	61+ / 19	46↑ / 34	62↑ / 18
Q4 2014	63 + / 17	50↑ / 30	63↑ / 17
Q3 2014	57 + / 23	39↑ / 41	66↑ / 14
Q2 2014	49+ / 31	35↑ / 45	63↑ / 17
Q1 2014	61 + / 19	51↑ / 29	64↑ / 16

Figures are based on 80 metros.

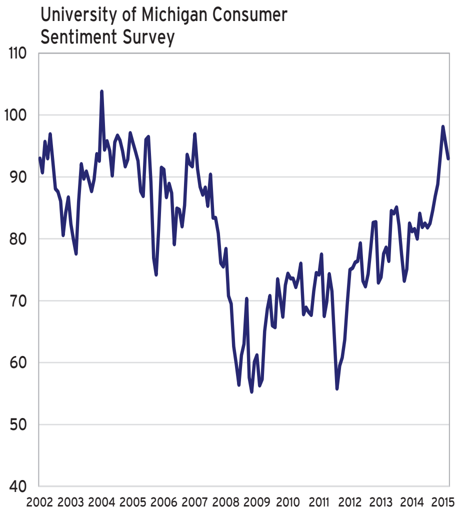
Malls Not Out Of The Woods Yet

Mall vacancies decreased during the quarter to 7.9%. This reverses the temporary (and minor) increase from last quarter. Over the last 12 months, the mall vacancy rate is unchanged. However, there is a bit of a tug of war going on in the mall sector. On the one hand, store closures have not yet ceased. Sears continued closing stores during the first quarter while a number of another national retailers will close stores throughout the balance of 2015. On the other hand, the economy and labor market continue to improve which should support retail spending. The outlook for demand is relatively optimistic, but this tug of war will play out slowly.



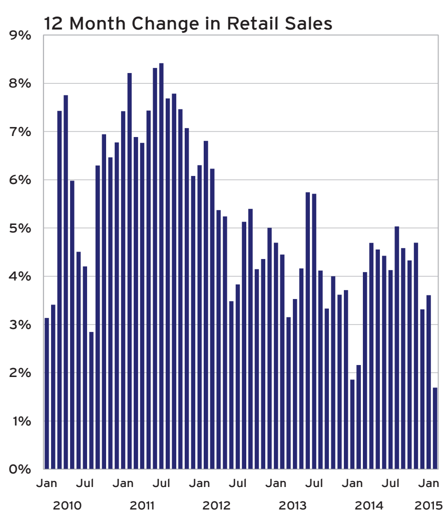
There remains no new ground-up development of true regional malls. There continue to be expansions and renovations of existing malls and the development of properties that are mall-like, but this is a mature subsector with little need for truly new properties at this juncture.

Asking rents grew by 0.5% in the first quarter and 1.8% over the last 12 months. This is the sixteenth consecutive quarter of rent increases at the national level for regional malls. High-end dominant malls and inferior malls are playing different roles in the mall subsector's recovery. Because vacancy rates at dominant malls are microscopically low, rent growth has been and will continue to be very robust, which will drive overall mall rents higher. However, with little to no vacancy left, they cannot help much on this front. Inferior malls still have elevated vacancy rates, therefore these malls will have to be the leaders if vacancy is going to continue to compress this year. However, with vacancy rates still so high at these malls, landlords have little leverage and therefore we will see much less upward pressure on rents coming from these lower caliber malls.



Fueled By Cheap Energy

Although the labor market data for March was disappointing and there is some risk of economic growth slowing in the first quarter due to historic cold temperatures, the overall outlook for the economy and retail real estate remains optimistic. The labor market is expected to generate roughly 250,000 or so jobs per month this year, many of which should be high-value-add positions that command higher compensation. Moreover, the number of people working part time on an involuntary basis continues to fall, as does the underemployment rate.



We have already seen the labor market and consumer spending surpass previous peaks. As they continue to reach new record highs, they will cause demand for retail space to increase. Construction for neighborhood and community centers, as well as malls, remains mired near historically low levels despite six years of economic growth. The market will need a much stronger rally before that changes. Therefore, the environment is ripe for vacancy compression and rent growth.

The last element is the massive decline in oil prices that has occurred over the last 9 months or so. Some were disappointed in the relatively weak consumer spending growth during the first quarter. However, it usually takes about 6 months of sustained low energy prices before consumers adjust their behavior. Although oil prices have been falling since last summer, the big leg down only began in November when oil was still trading above $80 per barrel. Therefore, it is still likely that the decline in oil serves as a catalyst for consumer spending, especially given all of the other favorable changes in the economy. We still expect neighborhood and community center vacancy to fall by another 20 basis points in 2015. Malls should perform similarly.