auction.com | Research

September 2015

RETAIL MARKET OUTLOOK REPORT

- Retail Segment Fundamentals and Outlook
- Top 5 Retail Buy and Sell Markets
- Retail Sector Metro Heatmap

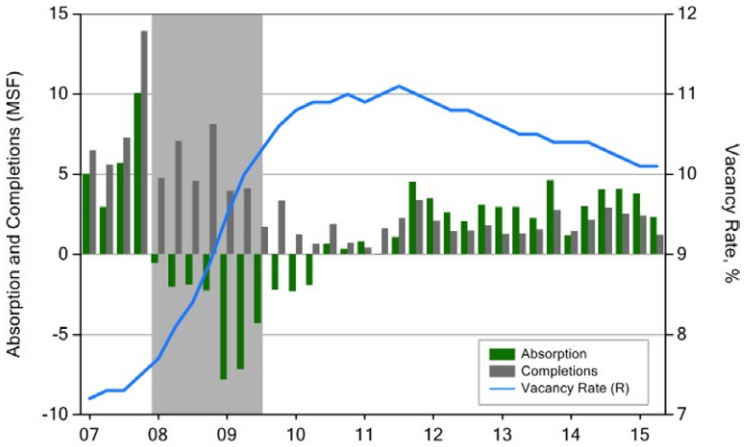
Retail Recovery Keeps on Truckin'

Retail fundamentals have continued their slow-but-steady recovery. Vacancies have reached a new post-recession low at 10.1%—an improvement of 30 bps from a year prior, but only 100 bps below its post-recession peak in 2011.

Absorption has outpaced supply in 14 of the past 15 quarters, averaging just over 3 msf per quarter in the past six quarters and slowly driving the vacancy rate down. While the trend is positive, we've yet to see absorption come close to its pre-recession numbers.

Likewise, supply additions have been scaled back since the recession. Since 2012, we've seen additions averaging 1.9 msf and ranging from 1.2 msf to 2.9 msf per quarter. While the supply additions are modest compared to pre-recession numbers, the difference between completions and absorption has been too low to dramatically affect vacancy rates.

SLOW AND STEADY RECOVERY IN RETAIL FUNDAMENTALS

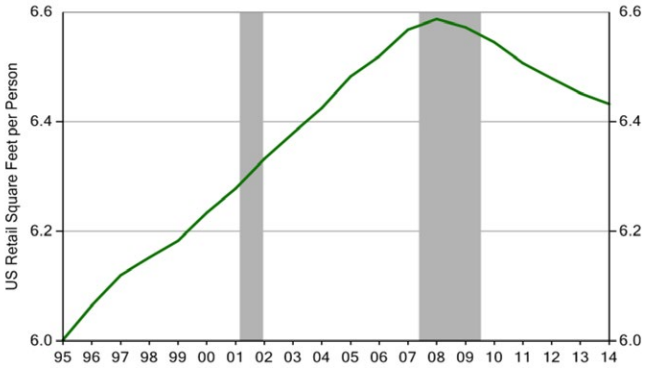


Sources: REIS, Auction.com Research

As E-Retail Expands, Store Footprints Continue to Shrink

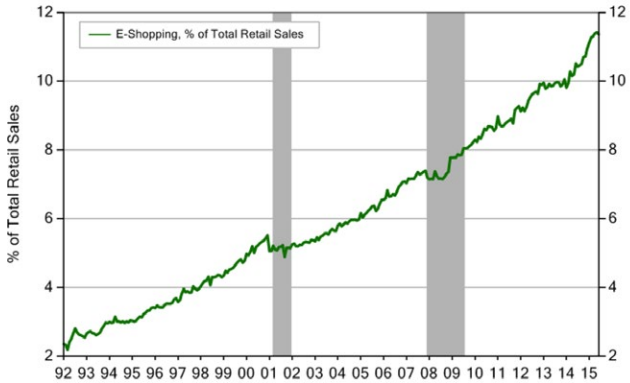
The percentage of sales attributed to e-retail continues to climb, reaching a record 11.6% in July 2015—a gain of 120 bps from one year prior. While e-retail is helping drive absorption in distribution and fulfillment centers, it continues to be a drag on retail space and is contributing toward the trend of smaller store footprints, with less space needed for inventory. Retail space on a per-person basis reached a ten-year bottom at year-end 2014

RETAIL SPACE PER PERSON HITS 10-YEAR LOW…



Source: Census, Auction.com Research

…AS E-SHOPPING CONTINUES TO GROW

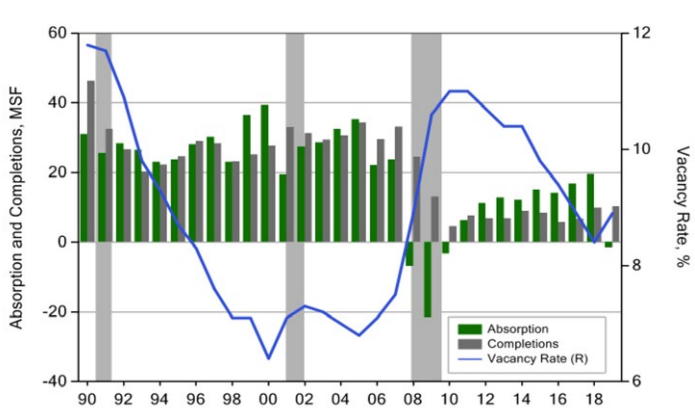


Source: Census, Auction.com Research

Retail Vacancy and Rents: What's in Store

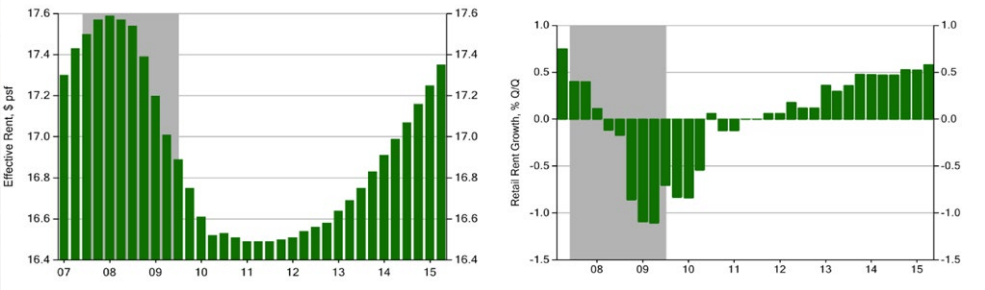
With the development pipeline remaining light, we expect national retail vacancies to descend from 10.4% at year-end 2014, down to 8.4% in 2018. Completions should average 8.2 msf per year through 2019, compared with 28 msf per year from 1990 through 2009. However, we expect completions to intensify through the forecast cycle, creeping above 10 msf by 2019.

UPTICK IN VACANCIES AND COMPLETIONS AHEAD?



Sources: : REIS, Auction.com Research forecasts

RENTS STILL ON THE RISE

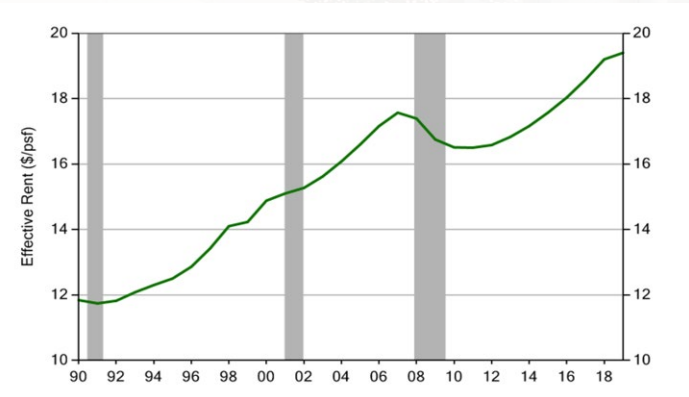


Sources: REIS, Auction.com Research

The vacancy rate will tread back up to 8.9% as the increase in deliveries runs headlong into a long-toothed economic cycle. This compares unfavorably with the 6-7% range that persisted through the late 1990s and 2000s.

We expect retail rent growth to accelerate in the near term, but the reintroduction of cyclicality to our forecast model in 2019—after ten years of uninterrupted growth—could interrupt demand acceleration and crimp the pace of retail rent growth.

HOW LONG WILL STRONG RENT GROWTH CONTINUE?



Source: REIS, Auction.com Research forecasts

Retail Sector Heat Map

The Southeast and West regions currently boast many of the top retail markets. The major South Florida markets – Orlando, Miami, Palm Beach, Fort Lauderdale, and Tampa – are improving on the strength of a resurgent housing market. Raleigh-Durham and Charlotte's growing economies are benefitting their retail markets, and the West Coast's sky-high incomes and hot job market have been a boon for retail.

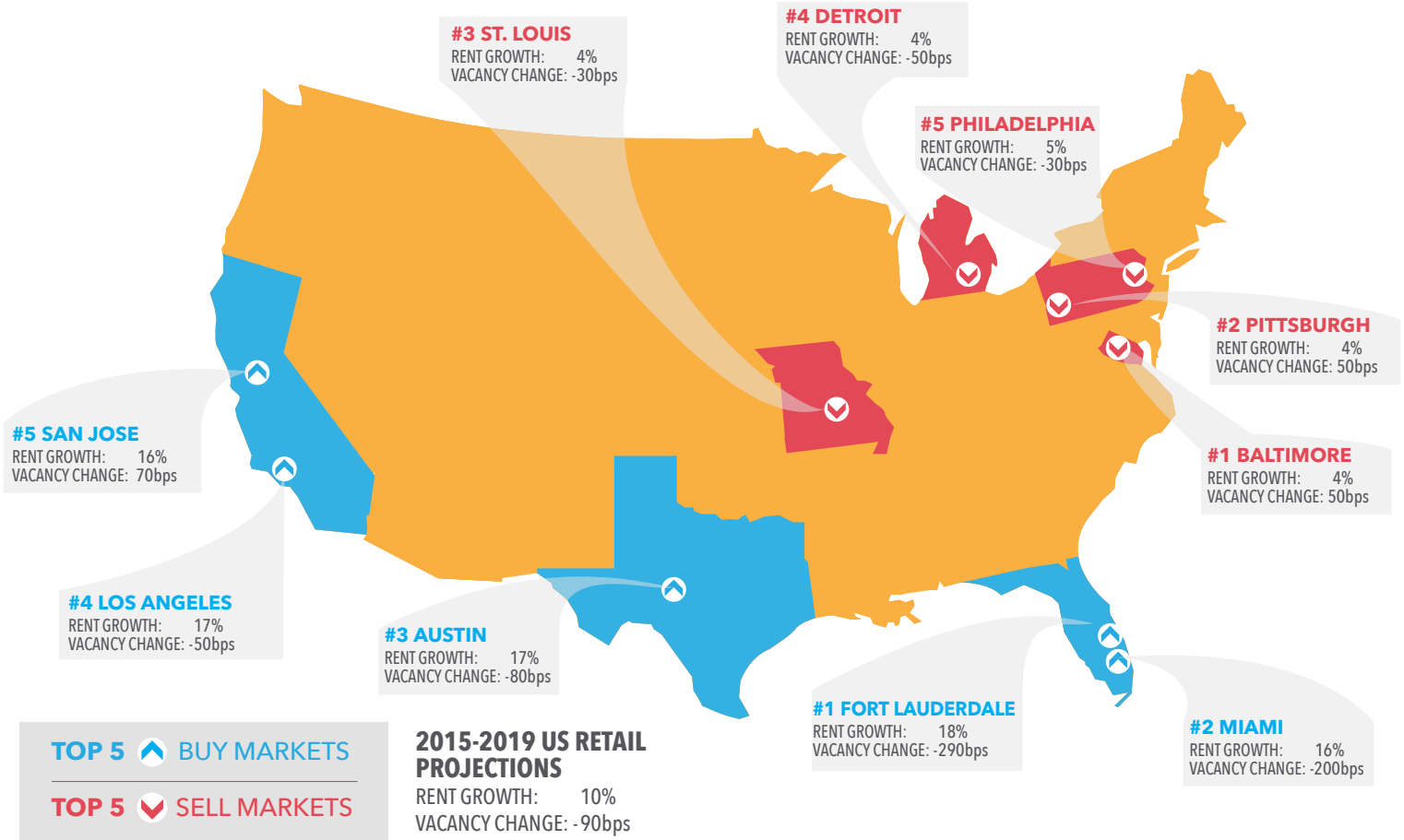
The term "demographics is destiny" is particularly apt for retail. The weakness expected for the Midwest and much of the Northeast retail markets also reflects the generally slow population growth in these areas, with Minneapolis and Boston as exceptions.

The Auction.com Research Retail Heat Map highlights regional and market-by-market dichotomies. The size of each market box represents each market's total retail square footage, while the combined size of each regional box represents the relative size of each region. The numerical rankings and colors represent the current and four-year projected strength of each market, with 1 and dark green signifying the strongest performers, and 6 and dark red denoting the weakest. The direction of the arrow in each box represents the direction each marketis moving in.

Sources: Auction.com Research

Top 5 Retail Buy and Sell Markets

Auction.com Research chooses top buy and sell markets based on projected NOI growth, vacancy improvement, rent growth, and valuations as reflected in the Auction.com Research Long Term Forecast.



2015-2019 US RETAIL PROJECTIONS

Top 5 Buy Markets	2015 Rents (psf)	2019 Rents (psf)	Change in Rents (%)	2015 Vacancies (%)	2019 Vacancies (%)	Change in Vacancies (bps)
Fort Lauderdale, FL	17.61	20.79	**18%**	8.9	6.0	**-290 bps**
Miami, FL	22.62	26.25	**16%**	5.8	3.8	**-200 bps**
Austin, TX	20.09	23.52	**17%**	6.0	5.2	**-80 bps**
Los Angeles, CA	27.83	32.62	**17%**	5.8	5.3	**-50 bps**
San Jose, CA	29.69	34.35	**16%**	3.8	4.5	**70 bps**

Top 5 Sell Markets	2015 Rents (psf)	2019 Rents (psf)	Change in Rents (%)	2015 Vacancies (%)	2019 Vacancies (%)	Change in Vacancies (bps)
Baltimore, MD	20.02	20.73	**4%**	6.7	7.2	**50 bps**
Pittsburgh, PA	14.59	15.18	**4%**	7.7	8.2	**50 bps**
St. Louis, MO	12.45	12.96	**4%**	12.6	12.3	**-30 bps**
Detroit, MI	15.40	16.08	**4%**	11.9	11.4	**-50 bps**
Philadelphia, PA	18.12	19.06	**5%**	9.6	9.3	**-30 bps**
US	**17.57**	**19.40**	**10%**	**9.8**	**8.9**	**-90 bps**

Top Buy Markets

Investors considering purchasing retail properties should consider these markets.

#1 Fort Lauderdale

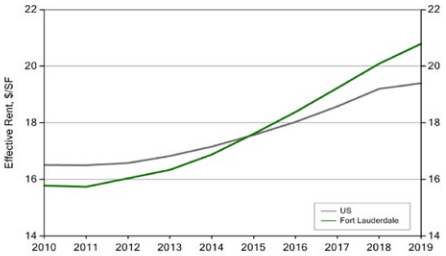
A South Florida housing revitalization is putting more money in consumers' pockets and driving an economic resurgence in Fort Lauderdale.

- Employment in the metro is seeing year-to-year growth in the 3.4% range, and is above its pre-recession peak.
- Unemployment is trending below the national average, down 110 bps from a year prior at 4.8%.
- The metro's population growth has outpaced the US rate, measuring 1.3% in 2014.
- Fort Lauderdale's economy is bolstered by its hospitality sector, which has seen rapid year-to-year job growth in the 4% range.

Fort Lauderdale retail vacancies and effective rents are poised to leave the US averages in the dust by 2019.

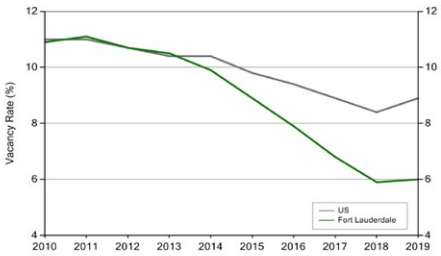
- Only modest supply additions have been made but absorption is still up, with an average of 106,000 sf of absorption per quarter over last six quarters
- The metro saw 3.3% effective rent growth in 2014 and that is only expected to grow as vacancies fall further.
- Fort Lauderdale continues to be a popular tourist city for both boaters and spring breakers, and NOI will grow on average 4.4% per year until 2019.

FORT LAUDERDALE VS US EFFECTIVE RENTS



Source: REIS, Auction.com Research forecasts

FORT LAUDERDALE VS US VACANCIES



Source: REIS, Auction.com Research forecasts

#2 Miami

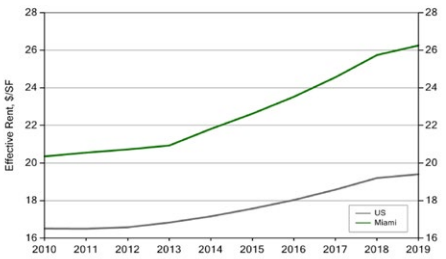
Miami's economy heated up with the weather this summer, and is poised for further gains.

- Total employment is up 2.6% year over year, and is back above its pre-recession peak.
- Miami's hospitality sector has further extended its employment peak, with jobs up 5.9% year over year.
- As restrictions on Cuba have eased, Miami could be in line for trade and hospitality to increase further.
- Unemployment for the metro, at 5.8%, is higher than the US average but is still falling year over year.

Miami's 6.2% retail vacancy rate is projected to drop even further, into the upper-3% range.

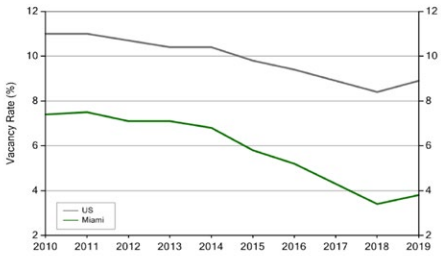
- Absorption has outpaced completions in each of the last four quarters.
- Year-over-year effective rent growth in the metro was 4.5% in the second quarter, compared to 2.1% for the US.
- Robust demand will continue to push vacancies down, and we project NOI will average 3.7% annual gains from 2015-19.

MIAMI VS US EFFECTIVE RENTS



Source: REIS, Auction.com Research forecasts

MIAMI VS US VACANCIES



Source: REIS, Auction.com Research forecasts

#3 Austin

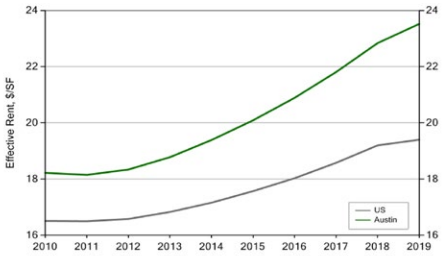
Tech-related growth, lack of oil exposure, and favorable demographics make Austin a standout among Texas metros.

- Austin's payrolls extended past their peak set in June, up 3.6% year over year and are trending up
- Unemployment is an extremely tight 3.2%, down 90 bps year over year and far outperforming the US overall
- Austin's population is also growing quickly— up 3% last year, which will contribute to further economic growth.

The Austin retail market is one of the few in the nation poised to benefit from both vacancy declines and strong rent growth.

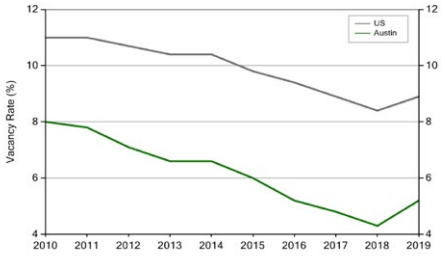
- Metro absorption has outpaced completions in all but one quarter in the last two years.
- Austin's vacancy rate is down to 6.3%, well below the US average.
- Effective rent growth is still accelerating, and capped off the second quarter of 2015 with a 4.2% year-ago effective rent increase.
- Vacancies are set to continue decline, and NOI is projected to average 3.6% annual growth through 2019.

AUSTIN vs US EFFECTIVE RENTS



Source: REIS, Auction.com Research forecasts

AUSTIN vs US VACANCIES



Source: REIS, Auction.com Research forecasts

#4 Los Angeles

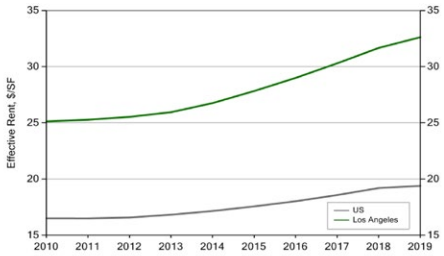
Los Angeles' expansion continues, and the region is benefitting from growth in many areas of its local economy.

- Employment is at an all-time peak, with year-over-year growth trending in the 2% range.
- Population growth typically trends below the US average, but 0.6% gains in 2014 are still solid for a large, mature metro area.
- Unemployment at 6.9% is 130 bps lower than a year ago, a sharp decline, but continues to trend higher than the US average.

With Los Angeles retail vacancies already tight, strong rent growth will drive the bulk of NOI gains.

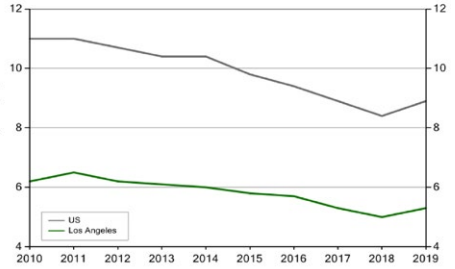
- Los Angeles' retail vacancy rate has been stuck in the low-6% range, but will decline slightly going forward amid better absorption.
- This low vacancy rate is driving strong effective rent growth of 3.8% currently, and will grow annually in the low- to mid-4% range, falling to 3.0% in 2019.
- NOI is expected to average solid 3.6% growth per year through 2019.

LOS ANGELES vs US EFFECTIVE RENTS



Source: REIS, Auction.com Research forecasts

LOS ANGELES vs US VACANCIES



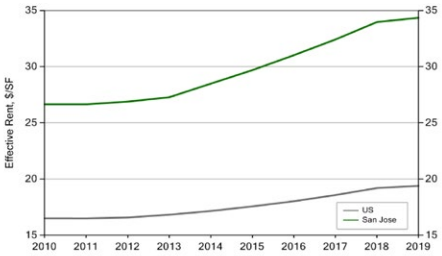
Source: REIS, Auction.com Research forecasts

#5 San Jose

San Jose's economy continues to expand at a torrid pace, driven primarily by the supercharged growth of the tech industry.

- San Jose has seen some of the strongest recent job growth in the US, with employment up 6.2% year-over-year. This is just shy of the peak set amid the early 2000s tech boom.
- The professional/business services sector is leading the charge, with jobs up 12.9% from a year ago. The information sector is almost at its prior peak and still growing fast. With 10.8% year over year growth, information sector jobs are just 5.2% short of their all-time peak.
- The 4% metro unemployment rate is well below the US average.
- The metro's population grew by 1.3% last year, substantially higher than the national average.

SAN JOSE VS US EFFECTIVE RENTS

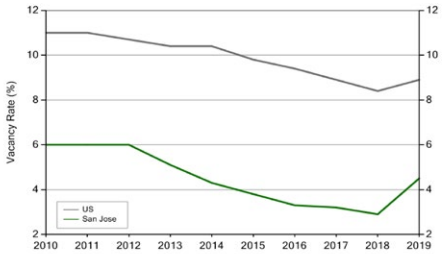


Source: REIS, Auction.com Research forecasts

San Jose retail vacancies are miniscule, which will encourage ample rent growth.

- The vacancy rate is currently a low 4.7%, well below the national average despite the large swath of completions added in the last four quarters.
- Rents are currently up 5% year-over-year, a massive acceleration from the 1% growth range seen as recently as 2013.
- Vacancy rates have little additional room for improvement, but strong rent growth will drive 3% average annual NOI growth through 2019.

SAN JOSE VS US VACANCIES



Source: REIS, Auction.com Research forecasts

Top Sell Markets

Owners of retail property in these markets might consider selling.

#1 Baltimore

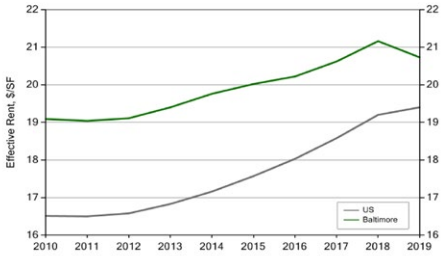
Baltimore's economy has surged recently, but the pace of expansion will cool down in the months and years to come.

- Employment is at an all-time high, up 3.1% from a year ago, but the majority of Baltimore's recovery has been marked by more modest low-to-mid 1% year-over-year job growth.
- Unemployment is slowly coming down but hovering above the national average
- Baltimore has seen population growth decelerate for four straight years; weak demographics strain the retail market outlook.

Retail absorption has been inconsistent and fleeting, and a range-bound vacancy forecast hurt NOI prospects.

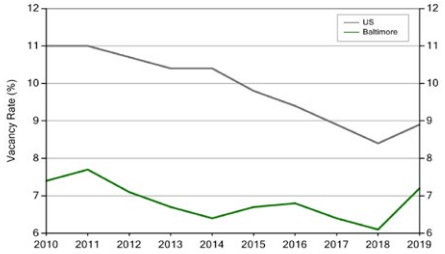
- Our forecasts have Baltimore averaging just 0.6% NOI growth per year through 2019.
- Baltimore's vacancy rate has gone up to 6.6%, as net absorption is negative in the past four quarters—even with no completions in the same period.
- Rent is up 1.5% from a year ago, and isn't projected to break 2% annual growth until 2017. Our projections, which are accounting for cyclicality in the market in 2019, have Baltimore rents declining 2% in that year.

BALTIMORE vs US EFFECTIVE RENTS



Source: REIS, Auction.com Research forecasts

BALTIMORE vs US VACANCIES



Source: REIS, Auction.com Research forecasts

#2 Pittsburgh

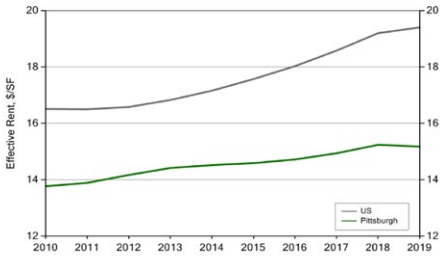
With oil-related tailwinds now gone, Pittsburgh is struggling with slow economic growth and a declining populace.

- Employment is up 2.9% year-over-year, but prior to this quarter Pittsburgh was seeing less than 1% year-over-year growth
- For the past two years, growth has been very slow in the professional/business services sector, resulting in range-bound employment
- Unemployment is 5.3%, right on par with US average, although it has stagnated thus far in 2015.
- Pittsburgh's population has declined for the past two years a major warning sign for future economic growth.

Pittsburgh's retail market is line for weak, uneven demand and slow effective rent growth.

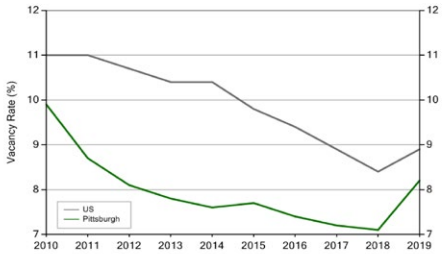
- Our forecast is projecting NOI growth in Pittsburgh to average a meager 0.7% per year from 2015-2019.
- Pittsburgh's vacancy rate will not make appreciable improvements from its current 8% level by year-end 2019.
- Aggregate net absorption has been negative over the past eight quarters, despite a lack of new retail development in the market.
- Rent growth has been decelerating in the past two years and falling behind the US substantially, and projections are equally as bleak.

PITTSBURGH vs US EFFECTIVE RENTS



Source: REIS, Auction.com Research forecasts

PITTSBURGH vs US VACANCIES



Source: REIS, Auction.com Research forecasts

#3 St. Louis

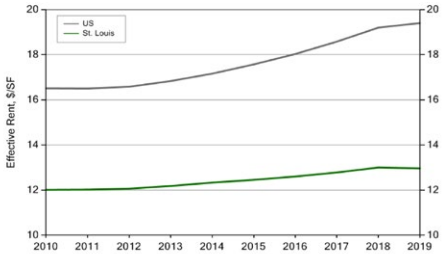
St. Louis employment is recovering at a snail's pace, and its economy is a laggard even among Midwestern metros.

- Employment in St. Louis is still short of its pre-recession peak, and its year-ago growth rate has been trending below the 1% mark recently.
- The unemployment rate is down 90 bps since last year, but it has crept above national average again.
- While the population is growing, it's increasing at roughly 1/5 the rate of the US, which will continue to hamper metro retail demand.

St. Louis' retail market will continue to struggle with moribund effective rent growth, thanks to a weak local economy.

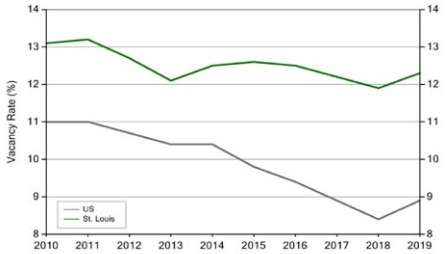
- Our forecast is projecting NOI growth in St. Louis to average 0.9% per year through 2019.
- Absorption has been a net negative in the past six quarters, pushing the vacancy rate up to 12.8%. Vacancies are projected to remain near the 12% range through 2019.
- The gap between US effective rent growth and St. Louis rent growth is widening, as St. Louis projects to average weak annual retail rent growth in the 1% range through 2019.

ST. LOUIS vs US EFFECTIVE RENTS



Source: REIS, Auction.com Research forecasts

ST. LOUIS vs US VACANCIES



Source: REIS, Auction.com Research forecasts

#4 Detroit

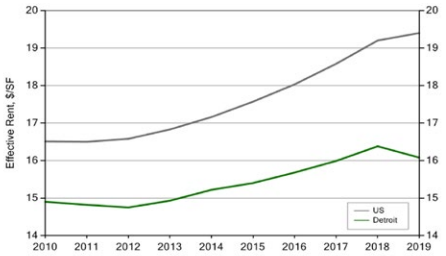
Detroit's dire fiscal situation and high crime rate will continue to hurt economic growth prospects.

- Employment in the Motor City is a whopping 11.8% short of its pre-recession peak, but has seen some recent improvement.
- Detroit's hurting manufacturing sector is also seeing growth year over year, but after some losses this year, employment still sits 38.2% short of its pre-recession peak.
- Unemployment is at 6%—higher than the national average.

Retail vacancies already trend far higher than the national average, and are not set to improve much.

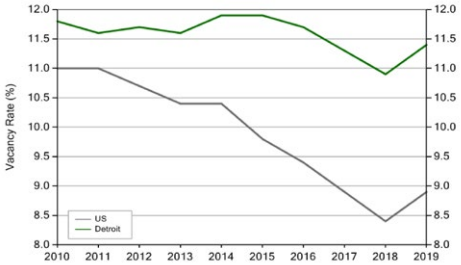
- Our forecast is projecting NOI growth to average 1% per year through 2019.
- Detroit's vacancy rate is currently at 11.8%, and is projected to stay in the mid- to high-11% range through 2019, dropping to 10.9% only in 2018, ballooning back to 11.4% a year later.
- Effective rents are forecast to average poor 1.1% annual growth through 2019 due to high vacancies and poor economic and demographic prospects.

DETROIT vs US EFFECTIVE RENTS



Source: REIS, Auction.com Research forecasts

DETROIT vs US VACANCIES



Source: REIS, Auction.com Research forecasts

#5 Philadelphia

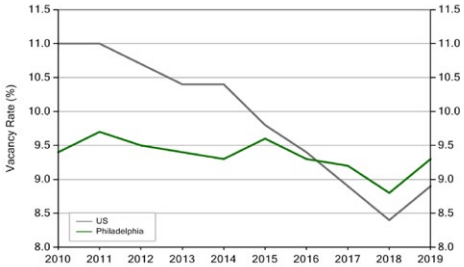
All is not sunny in Philadelphia, as economic expansion will be slow to develop.

- Employment is up 1.6% from a year ago, but growth has been stuck in the subpar 1% range for most of last two years.
- The key professional/business services sector saw job losses in early 2015, and though it's recovering, the rate is very slow.
- Unemployment in Philadelphia is at 5.6%, and has been bound in the mid-5% range since late 2014.
- Philadelphia's population growth has decelerated in each of the past four years, widening the gap between the metro and US growth rates.

Philadelphia's retail market projects to see vacancies gap higher than the US rate by 2019 as effective rents drop below the national average.

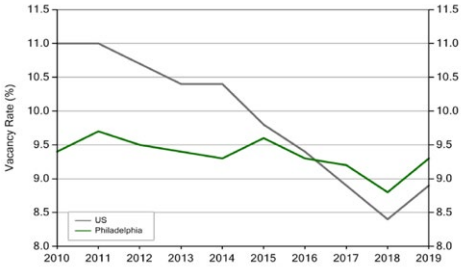
- Our forecast is projecting NOI growth to average 1.1% per year through 2019.
- Absorption has been sporadic in the past six quarters; however, the large amount of completions in the same time period (412,000 sf) has outpaced supply and limited vacancy improvements.
- Vacancies project to drop into the high-8% to low-9% range through 2019, leaving Philadelphia retail vacancies higher than the US average during the latter part of the forecast period.
- Rents are up 2% in the past year, and are forecast to reach 2.4% annual growth through 2018 before declining in our 2019 stress test year.

PHILADELPHIA vs US EFFECTIVE RENTS



Source: REIS, Auction.com Research forecasts

PHILADELPHIA vs US VACANCIES



Source: REIS, Auction.com Research forecasts

AUCTION.COM RESEARCH

Auction.com Research, led by Chief Economist and industry veteran, Peter Muoio, Ph.D. is based in New York. The group focuses primarily on custom analysis and business development support services, as well as industry-leading data science and predictive modeling initiatives. Follow our Research blog at **auction.com/blog.**