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Retail Market Analysis

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The retail market continued to stay strong through the beginning of the new year. As many still wonder when the eventual apocalypse will come, retail properties still continue to be sold, availability continues to shrink, and lease rates continue to rise. Net absorption was in the negative this quarter, much of that was due to the large amount of move ins that ended 2018. From 2018 to 2019 leasing activity is about on par, but in comparison to last quarter there was a steep drop of over 24% - though still having 144 transactions totaling 426,589 square feet. The year over year vacancy rate has dropped, but stays the same from last quarter at around 3.0%. New construction is expected to deliver around 200,00 square feet of product in 2019.

Much of the strength of retail in Portland can be linked back to the continued growth of the metro area - population and jobs alike. Portland's retail sector has remained pretty constant, which isn't true for everywhere else. A key factor may be the lack of a sales tax in the Oregon portion of the metropolitan area , making it more appealing vis-a-vis Washington for retail sales.

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FIGURE 1: SUBMARKET BREAKDOWN

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Source: Kidder Mathews

FIGURE 2: QUARTER OVER QUARTER TRENDS

Market Breakdown

	1Q19	4Q18
Direct Vacancy Rate	3.00%	3.00%
Availability Rate	4.00%	4.40%
Asking Lease Rate	$19.20	$19.11
Leased SF	426,589	565,176
Sold SF	840,864	1,223,559

Source: Kidder Mathews

FIGURE 3: PRODUCT TYPE TRENDS

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Source: Kidder Mathews

ABSORPTION

At the end of 2018 we saw consistent positive net absorption in the local retail markets, a trend that came to an end at the beginning of 2019. Overall it was a relatively lackluster quarter in terms of absorption, but the Central Business District and the Lloyd District helped to keep that number from dipping any lower.

The I-5 Corridor, Northeast, and Southeast really struggled to start the year. The I-5 Corridor and Southeast had strong overall years in 2018, so it will be interesting to see if they rebound in the quarters to come. Overall Portland as a whole saw the year start in the red, this is of concern considering the strong end of year numbers in total net absorption.

VACANCY

Vacancy rates in the retail market from the end of 2018 through the first quarter of 2019 are stable at 3.0%. Vacancy rates in the sought-after Northwest district are the lowest of all the submarkets at 1.5% and the Lloyd District was right behind at 1.6%. The I-5 Corridor has the highest vacancy rate of the submarkets at 3.6%, which would make sense given its drastic change in net absorption as well. With none of the submarkets reporting vacancy levels in excess of 5.0%, we would consider all of them to be supply constrained in aggregate with respect to retail space.

Shopping Centers starting the year off incredibly strong with 185,102 square feet of leasing activity already - Centers had a total of 309,807 in all of 2018. Specialty Retail struggled to start off the year with little to no leasing activity and the highest vacancy rate at 5.4%.

RENTAL RATES

Average leasing rates continue to climb in in the first quarter up to $19.20 vs. $19.11 to close out 2018. Portland's CBD and Northwest district led the way on average in terms of rental rates - $25.48 and $24.83 respectively. Both these districts can thank their lack of inventory to help drive up their rental rates. Southeast has the lowest rates at $17.47, but also has the most inventory in all of Portland.

Malls and Power Centers led the way for product type rental rates, both at about $23.17. Shopping Centers are coming in at $18.55. Just like the above-mentioned districts, product types with tight inventory demonstrated pricing power through escalating lease rates.

The biggest shift in cap rates so far have been in the Grocery/Power Center sector - though there have only been 4 sales thus far the average cap rate sits at 6.84% in comparison to 6.30% in 2018. Strip Centers cap rates have come down a bit to 6.73% against 6.81% in 2018 - so far there have been 31 such sales in the first quarter. Single Tenant cap rates still remain extremely strong at 5.84%, rising just a bit from 5.80% in 2018 - based on the 33 sales this year. Though still very early it's clear that no extreme shift in retail investment sales has occurred, and the assets still remain strong.

NOTABLE SALES IN THE RETAIL SPACE

Cascade Station	Portland, OR	MetLife	$140M	6.97%	399,055sf	Best Buy, HomeGoods, and Ross
Gresham Village Shopping Center	Gresham, OR	Quattro Develop-ment	$9.535M	4.76%	241,322sf	Starbucks and Outback Steakhouse
Terry Lane Retail Center	Grants Pass, OR	Private Investor	$5.6M	6.15%	10,199sf	MOD Pizza, Aspen Dental, Jersey Mikes, and Batteries + Bulbs

Source: Capital Pacific

WHAT TO KEEP AN EYE ON

The shift in Big Box Retail. As many believe the retail apocalypse still looms it can be seen clearly in the changing of Big Box stores. We've seen the departure of Toys "R" Us, Sears, and Shopko, to name a few, but it's those that are still hanging on that will need to make changes to survive. A popular phrase spoken more than ever in the retail industry is "right-sized" in terms of a retail space. One such retailer that has done this well in comparison to their competition would be Pacific NW based pet supply chain Mud Bay. With 17 Oregon locations, and 6 more slated to open this year, their footprint on average is 5,200 square feet. Fortunately for Mud Bay their competitors have not adapted as well. Brands like Petco and PetSmart, which occupy on average 14,500 square feet and 25,000 square feet per store respectively, were both recently downgraded in their credit ratings by the S&P for negative outlook. Mud Bay has seen their store count grow as they have been able to operate out of a smaller space. This makes the asset more appealing to potential investors as well, considering the lack of risk in the smaller box and not having to worry about potential back-fill of struggling brands in large footprints.

Pharmacy type assets have made strides to create more profit boosting tools within their spaces. As Amazon continues its dominance in all things retail, as well as the pharmaceutical industry, companies have needed to get creative on how to compete. CVS has their MinuteClinic which offers certain services normally done by a patients' primary care doctor, and now Walgreens is joining them. The goal is not to replace one's normal doctor, but rather be a service for those who need attention not during the normal 9am - 5pm physician schedule. Erik Gordan, a professor at the University of Michigan's Ross School of Business said, "the pharmacies need new profit centers and they need to add services that will draw customers to their stores instead of to Walmart or online sellers". These services will actually get customers inside the pharmacies for services that they need. A current trend that has been seen is that Millennials are hesitant to pick a primary doctor, as they have the mindset that they will get care when they need it, and don't need to establish it before then - a distinct advantage for these new services.

Source: Why More People Are Using CVS, Walgreens Instead of Family Doctor - Detroit Free Press

Beyond just doctor's services Walgreens and CVS are tapping into the dental industry as well. Six CVS locations are now offering in store SmileDirectClub services for invisible braces. Walgreens has done the same with a Florida location adding in an Aspen Dental office. Another tool these two brands are utilizing to attract and retain their customer base. The competition with Amazon rages on, and new tactics will be popping up every day on how to combat them.

Source: Don't Just Buy Toothpaste at CVS, Walgreens. Get Your Dental Care in Stores Too - Fortune