RETAIL MARKET ANALYSIS

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The Portland Metro's retail market experienced a positive but relatively un-noteworthy fourth quarter. Vacancy decreased slightly, rates increased slightly, and deliveries, though below 2014 levels, brought 820,000 square feet of retail online with absorption generally steady enough to absorb the new supply.

This occurred with a somewhat chaotic backdrop for the retail industry nationally. The bifurcation of the retail industry between luxury and bargain continued, with traditional mid-priced retailers continuing to struggle. E-commerce has continued to account for a greater amount of overall spending, while brick and mortar retailers have continued implementing omni-channel capabilities.

Holiday sales were up by 3 percent nationally according to the National Retail Federation. However, many mid-priced traditional retailers reported disappointing holiday sales in the fourth quarter. These included: Kohl's, Ralph Lauren, Macy's, Gap, and Best Buy among others. Clothiers were reportedly hit by unseasonably warm weather reducing demand for higher-priced winter clothing. The National Retail Federation reported 9 percent growth in online and other non-store holiday sales during the holiday season.

A sure sign of change, Wal-Mart announced it will close 269 stores and will end its Wal-Mart express small-store format after the format never caught on with consumers. Of the 269 stores, 154 are in the United States and of the 154, 102 are its express store format. Two are in the Portland area: its 8235 SW Apple Way store in Portland and its 17711 Jean Way store in Lake Oswego. Both are its Neighborhood Market format.

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Despite closing two Neighborhood Market stores locally, Wal-Mart looks to expand this format, which is slightly larger than the Dollar Store sized Express format. Despite the large number of closings, the verdict is out as to whether Wal-Mart will actually shrink its US store count this year. Based on upper-end estimates for US store openings in 2016, the chain would increase its number of stores, but, based on lower-end estimates, the chain would actually shrink its number of US stores for the first time in its history.

Wal-Mart projects lower profits in the short term due to continued investments in e-commerce and its work force. It has reportedly invested $2 billion in its e-commerce operations on expanding its workforce, investing in infrastructure, and opening up several logistics centers.

Amazon, in contrast, experienced continued growth during the year. According to an estimate by Macquarie Research, the firm captured 51 cents of every additional dollar spent online in 2015 in the US and a quarter of overall US retail growth. Though unconfirmed by Amazon, the Wall Street Journal reported that Amazon plans to open up to 400 brick-and-mortar bookstores. The move would be a marked change for the online-only company and follows Amazon's experimentation with the concept in Seattle.

Despite the mixed holiday results, Green Street Advisors reported 10 percent growth in commercial property prices in 2015 and 30 percent growth on average over the last three years. Mall values increased by 12 percent and strip-centers by 8 percent. And, according to JLL's Development Outlook for 2016, demand for retail space will continue to outpace new construction, which will compress vacancy and drive rents up in major markets. According to the report, stand-alone retail buildings, small neighborhood centers, and grocery-anchored and power centers will make up 76 percent of new construction. Growth will be from grocery and service-based retailers.

Cushman and Wakefield's Garrick Brown forecasted "16 Retail Trends to Watch in 2016." Highlights included:

- Struggling retailers and consolidation in some sectors will lead to the most store closures since 2010. By April, there will likely be many negative headlines, however, venture capital acquisition will probably expand some retail concepts easing some, but not all, of the losses.

- Retailers in general will look to a continued search for a balance between ecommerce and bricks and mortar. This will see greater investment in technology by traditional retailers, and greater investment in bricks and mortar and localized, distribution by ecommerce retailers.

- Food oriented retailers will continue to see gains in 2016 and will anchor many new developments. Fast casual (e.g., gourmet pizza and burgers, Asian fusion) is the quickest growing segment. Urban markets are experiencing quick growth with high-end food halls, with 24 such food halls under construction across the country. In the grocer segment, off-price, discount, and club warehouse will see strong growth alongside luxury, organic, small format, and ethnic.

- New developments are coming online 70 percent preleased. Retailers are consistently showing appetite for Class A space at a premium over Class B or even B plus. Suburban power and regional as well as core markets are seeing growth while malls and lifestyle centers will see losses.

- Sporting goods, fitness, medical, and home related retail are growing. Electronics, office supplies, bookstores, toy stores, video stores, and drug stores are shrinking (i.e., anything easily acquired online).

VACANCY

Vacancy continued to move downward, ending at 4.6 percent for the fourth quarter from 4.7 percent in the third quarter. This compares favorably to the overall national rate of 5.6 percent, but is higher than the fourth quarter rates in San Francisco (2.1 percent) and Seattle (4.3 percent). Four of the Portland Metro market areas are currently experiencing vacancy of below 4 percent: Northwest, Southeast, Southwest, and the Westside. Within these market areas, several submarkets stand out even lower: Close-In Southeast (2.3 percent), Close-In Northeast (1.1 percent), Barbur Boulevard/ Capitol (1.6 percent), Airport Way (2.2 percent), and Tualatin (2.1 percent). By retail sector, General Retail is the top performer, with 2.4 percent vacancy in the fourth quarter as compared to 6.8 percent for Malls, 4.6 percent for Power Centers, and 7.5 percent for Shopping Centers.

Table 1: Vacancy by Submarket, Fourth Quarter 2015

Market	Vacancy
CBD	4.3%
Clark County	6.7%
I-5 Corridor	4.0%
Lloyd District	6.1%
Northeast	4.4%
Northwest	3.6%
Southeast	3.9%
Southwest	3.8%
Westside	3.7%
Total	**4.6%**

Source: Costar

ABSORPTION

Portland ended the year with positive net absorption of 191,966 square feet. While this follows a much stronger third quarter in which 514,749 square feet was absorbed, it helped to increase total absorption for the year to 705,712 square feet. Clark County stood out with 342,672 square feet in absorption, while the CBD, Lloyd District, and the Westside dragged down absorption for the year. Several markets saw large deliveries and strong absorption: Clackamas/Milwaukie (46,385 square feet delivered / 111,203 square feet absorbed), Close-In Northwest (146,239 / 122,920), Orchards (216,953 / 247,621), Tualatin (53,008 / 50,832).

Table 2: Year-to-Date Absorption by Submarket, Fourth Quarter 2015

Market	YTD Absorption
CBD	-57,365
Clark County	342,672
I-5 Corridor	121,787
Lloyd District	-124,225
Northeast	119,777
Northwest	122,920
Southeast	134,674
Southwest	74,252
Westside	-28,780
Total	**705,712**

Source: Costar

RENTAL RATES

Rental rates continued a slow steady increase from recession period lows, ending the fourth quarter at $17.42 per square foot. This marks a healthy recovery from a low of $15.75 per square foot during 2012, but is still below the peak set during the last cycle of $18.33 per square foot in 2008. Seattle concluded the fourth quarter with an overall average rate of $17.56 per square foot and San Francisco ended at $37.31.

Table 3: Rental Rates by Submarket, Fourth Quarter 2015

Market	Quoted Rates
CBD	$19.69
Clark County	$16.90
I-5 Corridor	$21.61
Lloyd District	$15.76
Northeast	$17.35
Northwest	$21.45
Southeast	$15.86
Southwest	$18.16
Westside	$18.30

Source: Costar

DELIVERIES AND CONSTRUCTION

The fourth quarter saw eight buildings delivered for a total of 83,372 square feet (GLA). In total, 2015 saw 66 buildings delivered for a total of 820,026 square feet. This is below the amount delivered in 2014, but it trails only 2014 as the most delivered since the recession. The current pipeline suggests that deliveries will slow next year, with just 304,880 in the pipeline. Of the pipeline, 165,236 square feet are in the Clackamas/Milwaukie submarket and 54,887 are in the Sunset Corridor/Hillsboro submarket.

Key deliveries included: the Woodstock New Seasons with a total of 25,050 square feet and Sports Authority in the Hazel Dell marketplace with a total of 19,041 square feet.

The much-anticipated Pine Street Market, which is now anticipated to deliver April 1, 2016 in the CBD, will include a 10,000 square foot food hall featuring some of Portland's most-well-known local food businesses: Barista, Common Law, Food + Juice, Marukin, Olympia Provisions, Pollo Bravo, Salt & Straw, Shalom Y'all, and Trifecta.

Gramor Development broke ground on its Happy Valley Crossroads project. The project is an $80 million mixed-use project that will include 184,000 square feet of retail. Fred Meyer will anchor the site with a 144,000 square foot store. Killian Pacific continued construction on its LOCA @ The Goat Blocks project, which includes 97,000 square feet of retail space.

Table 4: Year-to-Date Deliveries and Total Under Construction by Submarket, Fourth Quarter 2015

Market	YTD Deliveries	Under Construction
CBD	0	0
Clark County	301,016	14,378
I-5 Corridor	169,423	14,455
Lloyd District	10,000	0
Northeast	26,832	41,320
Northwest	146,239	0
Southeast	47,325	179,840
Southwest	119,191	0
Westside	0	54,887
Total	**820,026**	**304,880**

Source: Costar

SALES

Table 4: Notable Investment Transactions, Fourth Quarter 2015

Property	City	Sale Price	Square Feet	Price/SF
Johnson Creek Shopping Center	Happy Valley	$32.1 M	109,209	$294
New Seasons Market	Portland	$15.68 M	25,050	$626
Cascade Marketplace – Safeway	Vancouver	$10 M	68,164	$147

Source: Costar