RETAIL MARKET ANALYSIS

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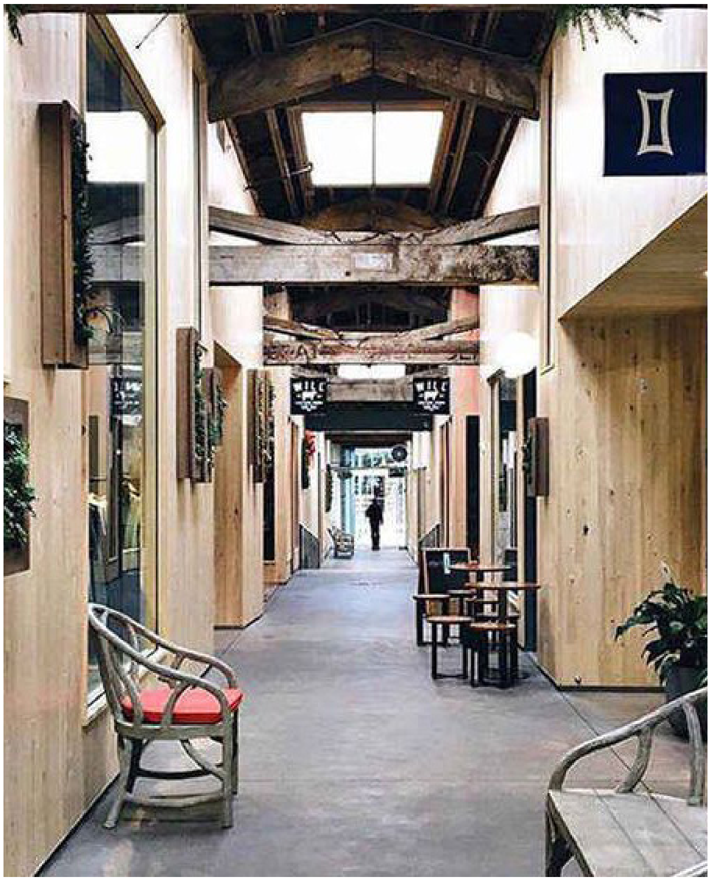
As 2017 came to a close, the national retail landscape outlook was positive. The year had been filled with hundreds of stories predicting the end of retail in what is commonly known as the "retail apocalypse." A quick Google search for the term "retail apocalypse" brings up many stories over the past year from publishers like The Wall Street Journal, Forbes and the Business Insider. The premise of the "retail apocalypse" is that online sales led by Amazon will increase to a point that traditional "brick and mortar" shopping channels are forced to close due to their sales being captured by online retailers. While it is true that there have been some high profile closings in 2017 including Macy's, Sears, Kmart and Gymboree among others have closed thousands of stores combined, it does not highlight all the new concepts and stores filing that space. With the headlines claiming the end of retail and the high profile closings, it is easy to believe that the retail market and the real estate the retailers occupy is in serious trouble. But a closer look at the retail landscape nationally paints a different picture.



In the fourth quarter of 2017, net absorption was positive. A total of 34 million square feet was leased across the nation. This follows three straight quarters of positive absorption in 2017. So despite the large spaces going dark, leasing activity is strong and retailers continue to

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take down more space than they are giving back. With the strong net absorption, vacancy rates decreased and rental rates increased in the final quarter of the year. The vacancy rate ended at a healthy 4.5 percent and rental rates averaged $16.45 per square foot for an increase of 3.89 percent in rental rates year over year.

Nevertheless, sales activity did lag behind 2016 numbers. Through the first three quarters of the year, sales volume in 2017 was $4.8 billion dollars less than 2016. Despite the drop in total sales volume, some investors may have captured additional value during sales as cap rates compressed by an average of seven basis points (bps) in the last year to end at 7.04 percent.

Looking closer to home, the Portland market closely mirrored the national retail market. Net absorption for the quarter was positive, a total of 560,766 square feet was leased. These strong numbers are in spite of the large departures in the market including the Macy's in downtown. Additionally, Fred Meyer announced it would close its location at 82nd Avenue and Foster during the fourth quarter.

Vacancy rates have decreased in the year, ending at 3.8 percent. Rental rates trended upwards and ended the year at an average of $19.34 per square foot. As with the national market, the only thing down in the year is total sales volume. Cap rates have trended higher in the year but are still 26 bps lower than the national average, ending at 6.78 percent.

Heading into 2018, the market should remain healthy. Currently there are 958,376 square feet of retail under construction. Many of the large projects in the market are either build-to-suit or have significant pre leasing. Cedar Hills Crossing is expanding its footprint and Sunset Lanes will take 44,000 square feet of that project. Additionally, there are 38,000 square feet related to a 24-Hour Fitness project at Gladstone Crossing, which is set to deliver in early 2018. The lack of speculative retail space will keep inventory and vacancy rates low, which should put continued upward pressure on asking rates.

VACANCY

The fourth quarter brought the year-end vacancy rate in Portland down to 3.8 percent. This is a strong finish for the market. Over the summer, the market slowed down with a vacancy rate of 4.3 percent at the end of the third quarter.

Portland is not expected to get a large amount of new retail construction in 2018. There is a possibility of some big box retailers closing in the year but overall the vacancy rate should hold around its current level heading into the New Year.

VACANCY

Table 1: Portland Retail Vacancies by Submarket, Fourth Quarter 2017

Submarket	Q4 Vacancy Rate	Q3 Vacancy Rate	Change from Previous Quarter
CBD	9.3%	9.4%	(0.1%)
Clark County/ Vancouver	5.1%	6.3%	(0.8%)
I-5 Corridor	4.8%	6.0%	(1.2%)
Lloyd District	2.5%	7.6%	(5.1%)
Northeast	3.1%	4.7%	(1.6%)
Northwest	2.9%	3.1%	(0.2%)
Southeast	3.3%	3.8%	(0.5%)
Southwest	3.0%	3.7%	(0.7%)
Sunset Corridor	3.4%	3.1%	0.3%
Total	3.9%	4.3%	(0.4%)

Source: Kidder Mathews

Table 2: Portland Retail Vacancies by Product Type, Fourth Quarter 2017

Property Type	Q4 Vacancy Rate	Q3 Vacancy Rate	Change from Previous Quarter
Malls	1.9%	3.8%	(1.9%)
Power Centers	2.8%	4.0%	(1.2%)
Shopping Centers	6.6%	7.2%	(0.6%)
Specialty	0.0%	0.0%	0.0%
General Retail	2.6%	2.7%	(0.1%)

Source: Kidder Mathews

ABSORPTION AND LEASING

Absorption over the last year has been up and down. Heading into the fourth quarter, year-to-date absorption was negative 48,773 square feet. However, the fourth quarter experienced positive net absorption to end the year at 214,242 square feet.

Kidder Mathews reports that there were 160 leasing transactions in the quarter for a total of 455,517 square feet of retail space. They report that in the Hillsboro submarket, Marshalls and Sierra Trading Post opened locations for a total of 43,214 square feet. Additionally; H Mart opened their doors at the former Zupan's market on Southeast Belmont in Portland.

ABSORPTION AND LEASING

Table 3: Portland Retail Absorption, Fourth Quarter 2017 and YTD.

Submarket	Q4 2017 Net Absorption	YTD Net Absorption
CBD	11,805	(186,649)
Clark County/ Vancouver	137,808	(21,749)
I-5 Corridor	46,103	90,104
Lloyd District	75,363	(79,329)
Northeast	60,279	53,329
Northwest	(2,321)	(6,460)
Southeast	151,685	175,296
Southwest	39,096	57,095
Sunset Corridor	(33,771)	(27,814)
Total	486,047	214,242

Source: Kidder Mathews

RENTAL RATES

Once again, rents increased in the final quarter of the year to finish at an average of $19.43 per square foot, NNN. Kidder Mathews reports that this is a 6.3 percent increase year-over-year. This level of rent growth betrays the narrative that retail is in an "apocalypse.". Close-in retail is on average more expensive. The CBD has the highest average rate at $22.69 per square foot, NNN. The lowest reported submarket is Southeast with an average rent of $18.36.

With a relative lack of supply in the market, Landlord's will continue to have the upper hand. This has allowed a steady increase in rents quarter after quarter but it remains to be seen how long this steady rent growth can be sustained.

DELIVERIES AND CONSTRUCTION

A total of seven retail projects were delivered to the market this quarter which added 53,2287 square feet to the market—38,000 sq. ft. will be occupied by Restoration Hardware at their new concept store at NW 23rd and Glisan and 36,000 square feet will be occupied by 24 Hour Fitness at their new Gladstone Crossing location.

Kidder Mathews notes that there are 16 retail projects under construction with retail component of 10,000 square feet or larger.

Table 4: Notable Retail Developments, Fourth Quarter 2017

Building/Address	Market	SF	Delivery Year
Cedar Hills Crossing Community Center	North Beaverton	128,652	Q2 2018
Cedar Creek Plaza	I-5 Corridor Retail Market	70,000	Q3 2018
The Union at St. Johns	Rivergate	80,000	Q1 2018
The Waterfront Vancouver	Clark County	28,528	Q2 2018

Source: CoStar and Kidder Mathews

SALES TRANSACTIONS

If there was a week spot in the retail market in 2017 it was the overall number of sales transactions. The total sales volume for 2017 was less than in 2016. Through three quarters of 2017 there were a total of 40 sales transactions, which represented more than $40 million and an average price per square foot of $160.07. In contrast, during the same time frame of 2016 there were a total of 57 sales transactions, representing $598 million with an average price per square foot of $186.80. The decrease in price is reflected in an increase in cap rates year-over-year. Cap rates in 2017 ended at 6.78 percent which is 24 bps higher than 2016.

Despite the increase in cap rates, well-positioned properties with long-term national tenants are trading at rates below six percent. Kidder Mathews highlights two such properties including a 7-Eleven in Vancouver that sold at a 5.58 percent cap rate and a Walgreens on East Burnside in Portland that sold at a cap rate of 5.51 percent.

Over the course of the year there were a few large transactions but the bulk of sales were from smaller single tenant properties. The largest transaction of the year was by Kimco Realty Corporation. They purchased the 732,542 square feet Jantzen Beach Center for $131.8 million. Additionally Division Center at 11908 SE Division sold for $33 million or $270.49 per sq. ft. and Martinazzi Square in Tualatin sold in early 2017 for $16 million or $319.31 per sq. ft.