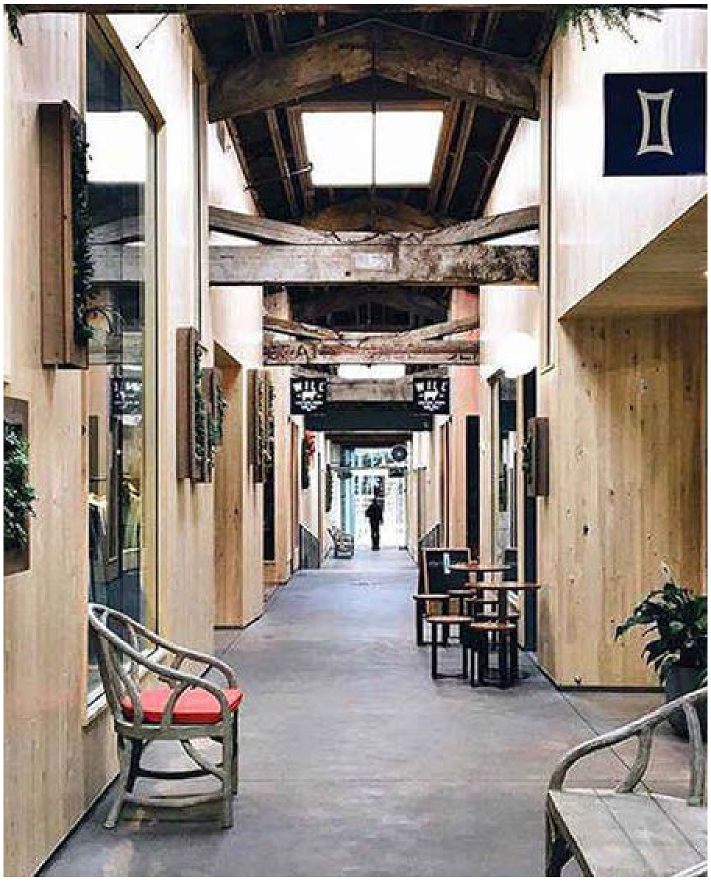
RETAIL MARKET ANALYSIS

MELISSA MEAGHER
Portland State University

In the second quarter of 2018 the idea of success in the national retail landscape is continuing to be redefined. Last quarter, the looming idea of retail disruption came into focus with the downfall of Toys R Us, the closing of several Sears stores, as well as Albertson's push to acquire the drug store chain Rite-Aid. However, despite the notion of a retail apocalypse physical retail is still alive and well. The only difference is: the trends now point toward an emphasis on "experience per square foot," rather than product sales and price.

A retail trend report by KPMG finds that physical space will continue to be successful if it offers a customer experience that far surpasses customer expectations. By 2020, millennials driving digital technology use will make up 40 percent of consumers in the United States, putting instant consumer gratification and shareable experiences at the top of the list. In an article about the shifts of retail, Joe Mach, President of Veritone North America, states:

> For younger generations, the purchasing experience tends to supersede the purchase itself; rather than trips to just make purchases, shoppers are drawn to in-store experiences that are digitally-connected and personal. Merchants are seeing success by making the in-store experience worthy to write home about—redefining the in-store experience by blending online with in-store.



Melissa Meagher is a Masters of Real Estate Development candidate through a joint program of Portland State University's School of Business Administration and School of Urban Studies and Planning. In addition, Melissa received her Bachelor's of Arts from U.C. Berkeley and is an asset manager for market rate and affordable housing, specializing in the marketing and design of innovative mixed-use projects. She is the 2018 Society of Industrial and Office Realtors Fellowship recipient and scholar. Any opinions expressed are those of the author solely and do not represent the opinions of any other person or entity.

The national retail market supports this evolving trend of physical space with a 6.1 percent vacancy rate with a message for merchants: physical space is there, it is just adapting. In its most recent CRE Research report, Trepp notes that "opportunities exist for the rise of new players with unique product offerings to fill their space [and] service-oriented retailers continue to dominate while niche lifestyle brands find new ways to expand into the physical realm."

According to Cushman & Wakefield's U.S. MarketBeat, the second half of 2018 will continue to see a widening gap between shopping mall classes. Class A malls will focus on new ideas at market rents, while Class B will search for non-traditional mall tenants and innovation to survive. Strategies to appeal to the growing millennial consumer base by creating customer experiences and building brand awareness will remain vital.

In its partnership with Live Nation to reinvent the former Nordstrom space, Portland's Lloyd Center Mall is an illuminating example of out of the box retail capturing experience per square foot. Bob Dye, General Manager of the Lloyd Center Mall, states:

Lloyd Center's metamorphosis began in 2015 … and continues in 2018 with the redevelopment of the former Nordstrom's into a premier concert venue in the Pacific Northwest and the development of an all new, luxury seating 14-plex Regal Cinema and IMAX in the former Sears building. These are essentially the "bell cows" for other leasing, with a major focus on local cuisine. When you step back, what exactly are we creating? When you pair food, entertainment, retail and local services you create an experiential product. We are dedicated to adapting not only in current times but for the future as well. Bottom line? We're not going anywhere and are focused on providing even more to our community.

This type of push toward nontraditional, inventive spaces has kept Portland's vacancy rate at 3.2 percent at the end of second quarter. The market experienced 83,327 square feet of positive absorption, with an average asking rent of $18.96, above the national average asking rate of $17.01 per square foot. With construction picking up, options to redefine the definition of retail is at the hands of those who seek to match today's constantly moving sphere of technology and innovation.

VACANCY

At the end of the second quarter, the vacancy remained strong at 3.2 percent, with little change to the retail market. However, Portland's vacancy rate continued to decrease from 3.8 percent in 2017. The largest change in vacancy rate involved the CBD market, seeing a drop from 10.5 percent to 5.8 percent in the second quarter.

General retail properties' vacancy rates remained strong with rates lower than two percent at the end of the quarter. Malls also saw a slight decrease from 3.9 percent to 3.8 percent in the past quarter.

VACANCY

Table 1: Portland Retail Vacancies by Submarket, Second Quarter 2018

Submarket	Q2 2018 Vacancy Rate	Q1 2018 Vacancy Rate	Change from Previous Quarter
CBD	5.8%	10.5%	(4.7%)
Clark County/ Vancouver	4.4%	4.8%	(0.4%)
I-5 Corridor	3.9%	4.6%	(0.7%)
Lloyd District	3.5%	3.0%	0.5%
Northeast	2.4%	3.1%	(0.7%)
Northwest	2.2%	2.3%	(0.1%)
Southeast	3.0%	3.1%	(0.2%)
Southwest	3.1%	3.4%	(0.3%)
Sunset Corridor	2.5%	2.2%	0.3%
Total	3.4%	3.7%	(0.3%)

Source: Kidder Mathews

Table 2: Portland Retail Vacancies by Product Type, Second Quarter 2018

Property Type	Q2 Vacancy Rate	Q1 Vacancy Rate	Change from Previous Quarter
Malls	2.5%	2.2%	0.3%
Power Centers	2.0%	2.4%	(0.4%)
Shopping Centers	5.9%	6.1%	(0.2%)
Specialty	0.0%	0.0%	0.0%
General Retail	2.2%	2.6%	(0.4%)

Source: Kidder Mathews

ABSORPTION AND LEASING

Ending last quarter with a positive 282,830 square feet of absorption, the market is still seeing a net absorption positive of 83,327 square feet in quarter two. The shopping center, power center and mall sectors all reported positive absorption with 15,340 square feet, 17,214 square feet, and 7,983 square feet, respectively. Specialty centers experienced the only negative net absorption in second quarter with negative 3,042 square feet.

ABSORPTION AND LEASING

Table 3: Portland Retail Absorption, Second Quarter 2018 and YTD

Submarket	Q2 2018 Net Absorption	YTD Net Absorption
CBD	12,137	14,660
Clark County / Vancouver	(6,403)	130,505
I-5 Corridor	20,405	29,471
Lloyd District	(28,614)	11,567
Northeast	66,821	140,179
Northwest	35,720	8,042
Southeast	32,194	123,997
Southwest	35,281	(39,869)
Sunset Corridor	(10,981)	(27,887)
Total	127,621	277,293

Source: Kidder Mathews

RENTAL RATES

Rental rates remained relatively stable from first quarter to second quarter. According to Kidder Mathews, the average asking lease rate was $18.96, a 1.28 percent increase from the end of the second quarter in 2017. Most notably, average rental rates increased $21.02 in first quarter to $22.44 in second quarter in the CBD submarket.

Table 4: Second Quarter Average Rental Rates by Firms

Brokerage	Kidder Mathews	Cushman & Wakefield	Norris & Stevens	Costar
Q2 Average Rental Rate	$18.96	$18.99	$17.35	$17.24

Source: CoStar, Cushman & Wakefield, Kidder Mathews, and Norris & Stevens

Table 5: Portland Retail Asking Rents by Submarkets, Second Quarter 2018 v. First Quarter 2018

Submarket	Q2 Avg Rental Rate	Q1 Avg Rental Rate	Change from Previous Year
CBD	$22.44	$21.02	$1.42
Lloyd District	$20.52	$24.44	($3.92)
I-5 Corridor	$18.36	$19.66	($1.30)
Clark County	$18.12	$18.29	($0.17)

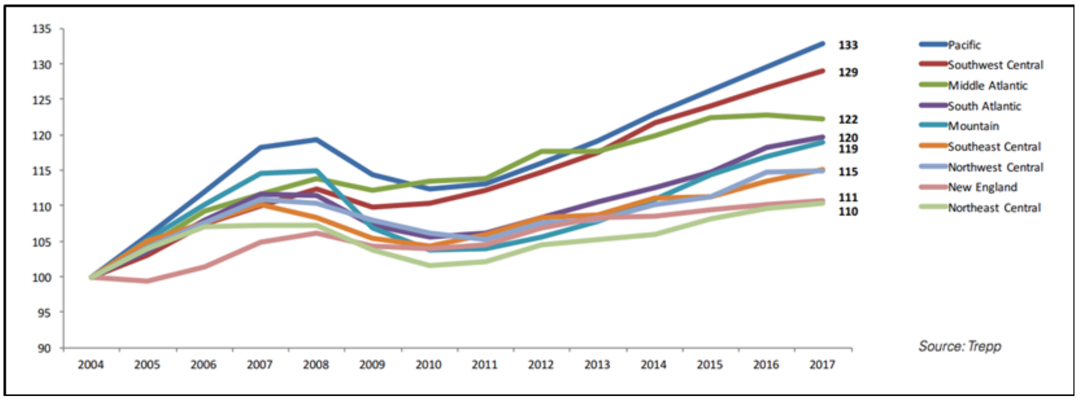
Source: Kidder Mathews

SALES TRANSACTIONS

Portland's opportunity for continued growth is apparent and leasing activity continues to be robust. Trepp noted Portland's prime positioning in terms of current and future growth:

> Boosted by rising population levels and robust economic growth, the Pacific US ranks first in retail NOI growth (+33 percent) for the time framed analyzed and was the region with the greatest NOI increase for the 2017 fiscal year (+2.4 percent). With budding tech hubs and travel hotspots in areas like Silicon Valley, California; Portland, Oregon; Seattle, Washington; Anchorage, Alaska; and Honolulu, Hawaii, Pacific region states draw in tourists from all over the world, as well as millennials seeking high-paying employment and desirable urban lifestyles.

Figure 1: NOI Growth Index by U.S. Region



Source: Trepp

In second quarter, the Southeast and Northeast submarkets had the most leasing activity at midyear with 120,000 square feet. Natural Grocers opened its fifth Portland location at 5029 NE Martin Luther King Jr. Blvd. WinCo Foods leased the 60,673 square foot former Haggen Food and Pharmacy in Oregon City. VRTech Arena also leased the 14,000 square foot space at 9360 SW Beaverton Hillsdale Hwy in the 217 Corridor/Beaverton submarket. As opposed to the previous lease that included the Valley Theater, VRTech is a technology company specializing in interactive events. Lastly, Live Laugh Art, an art activity center, leased the 8,297 square foot space at 9120 SW Hall Blvd in the Tigard Market. The business emphasizes its fun, collaborative workshops attempting to cater to the growing consumer sector hoping for memorable experiences.

Table 6: Select Top Retail Leases – Based on Leased Square Footage for Deals Signed in the Second Quarter 2018.

Building	Submarket	SF	Tenant Name
1. 19701 Highway 213	Oregon City	60,673	WinCo
2. 9444 N Whitaker Rd	Airport Way	34,000	N/A
3. 5029 NE MLK Blvd	Northeast	25,000	Natural Grocers
4. Menlo Park Plaza	East Columbia Corridor	22,019	N/A
5. 3265 SW Sundial Ave	East Columbia Corridor	15,600	N/A
6. Valley Plaza – Bldg 2	217 Corridor/Beaverton	14,000	VRTech Arena
7. 555 NW 12th Avenue	CBD	9,971	N/A
8. 11745 SW Pacific Hwy	217 Corridor/Beaverton	9,772	N/A
9. 9120 SW Hall Blvd	217 Corridor/Beaverton	8,297	Live Laugh Love Art
10. 800 NW Eastman Pky	Gresham	6,550	Schmizza Public House

Source: Costar & Commercial Realty Advisors

DELIVERIES AND CONSTRUCTION

A total of seven retail projects were delivered this quarter, which added 55,011 square feet to the market. This adds to the 357,363 square feet of retail space constructed in the last four quarters, according to Norris & Stevens. The 901 NW 21st Avenue project broke ground in the first quarter of 2017 and was delivered to the market with 35,200 square feet.

Retail inventory in the Portland market area totaled 189,755,970 square feet in 18,309 buildings and 1167 centers at the end of the second quarter of 2018. Currently, there is an additional 1,129,274 square feet of retail under construction across the market and new development remains strong. According to Costar, much of the retail being constructed in Portland is already 100 percent pre-leased, which continues to reflect healthy tenant demand.

Table 7: Notable Developments Currently Under Construction, Second Quarter 2018

Building	Market	SF	Preleased	Delivery Year
Avery Park	1-5 Corridor	39,115	100%	Q4 2018
Cornelius Place	Westside	30,000	100%	Q4 2018
Sideyard	Lloyd District	20,000	73%	Q4 2018

Source: CoStar

SALES TRANSACTIONS

Sales volume at the end of the second quarter lowered to below one million square feet; however, with an average cap rate of 6.4 percent in the Portland market, investors remain confident. Trading for $179.85 per square foot, the 732,542 square-foot Jantzen Beach Center still remains 2018's largest sale. However, in second quarter, March Hare LLC and McMincenter, LLC acquired the 135,873 square-foot McMinnville Plaza at 2400-2420 NE OR-99W for $17.4 million. In addition, the 139,831 square foot Wood Village Town Center was sold for $26.6 million to Wood Village Retail I, LLC and was the company's first retail acquisition in the Pacific Northwest. The 93,864 square foot former Fred Meyer site at 5253 SE 82nd Avenue also closed, bringing a rare redevelopment opportunity for new owner Terry Emmert.

SALES TRANSACTIONS

New opportunities for consumer experience leave plenty of options for retail spaces to thrive. As Jeffrey Boerebach, Research Analyst, finds in his latest Industry Sector Series for ICSC, the new retail state of mind is “the need to enjoy,” rather than the “need to buy.” He concludes, “Retail will become less focused on transactions and more about connecting with the consumer. Location and shop quality will become even more important.” The second half of 2018 will reveal the future winners and losers in their realization and ability to create an unforgettable experience amidst this constantly evolving retail market.