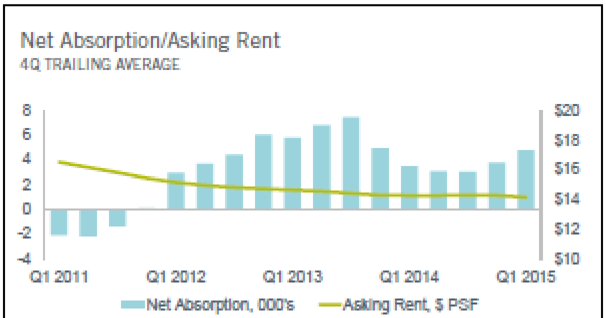
May 2015

Phoenix Retail Market Continues to Improve…Slowly

Recent Trends

The Phoenix retail market continues to improve, albeit at a more gradual pace than many expected, with ongoing positive net absorption and modest vacancy decline. Since 2011, the market has absorbed 6.8mm SF, while adding only 1.6mm SF. As of Q1 2015, average vacancy throughout the metro was 9.3%. This compares to peak vacancy of over 12% in 2011. Despite the fact that vacancy has fallen 15 of the past 20 quarters, average rents have to yet to rise. In fact, rents have yet to demonstrate that they have actually bottomed.



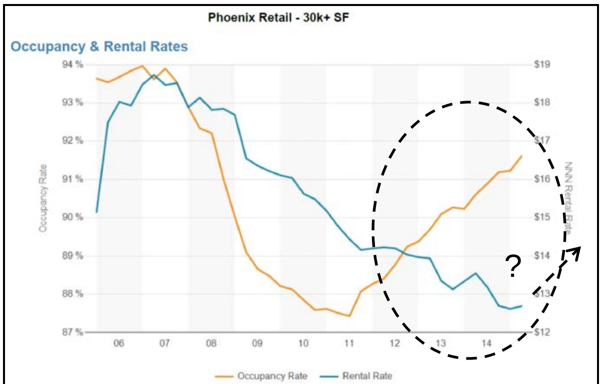
Source: DTZ

Market Impact

The retail market has been dealing with several cross currents. On one hand, traditional demand drivers like population growth and job growth have been trending in the right direction, which has helped to drive positive net absorption. On the other, macro factors that aren't entirely unique to Phoenix have had a negative impact on the local retail market. For example, a delayed recovery in the housing market has curtailed retailer expansion. In addition, the continued surge in e-commerce has caused many retailers to shift business models towards omni-channel growth, closing weaker physical locations and reinvesting in the e-commerce distribution chain.

New retail supply in Phoenix has been extremely limited since 2009. In fact, the cumulative new supply added over 5 years from 2010 to Q1 2015 (6.2mm SF total) represents less than the <u>annual</u> amount of new supply added each year over 6 years from 2003 to 2008 (8.9mm SF annual average). And 2015 isn't expected to be much different.

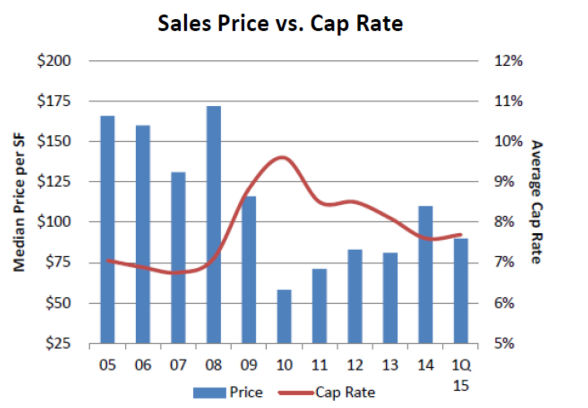
Demand for Class A has been strong, while demand for Class B and C has been much weaker.



Source: CoStar, Everest Holdings

Opportunities

Retail benefits from new rooftops and we believe that the Phoenix new home market is at historic lows, but poised for a strong and sustained recovery. Everest sees an opportunity in acquiring well-located, fundamentally-sound, Class A retail--particularly those seemingly rare projects with high vacancy and/or distressed ownership--in strong submarkets that are most likely to benefit from new home construction in the future. Rents have yet to start rising on a market-wide basis. But given the traditional lag between rent and occupancy movements and the fact that occupancy has been improving for 4 straight years, we expect retail rents to start rising in 2015 or 2016 and remain strong for several years thereafter.



Source: Colliers

Everest Insight

The strongest performing submarkets are not always obvious. While the fact that Scottsdale has both the highest rents and lowest vacancy in the metro is not a surprise, it is interesting to note that the #2-3 top submarkets are South Phoenix and North Central, respectively, for rents and West Phoenix and South Phoenix, respectively, for vacancy.

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