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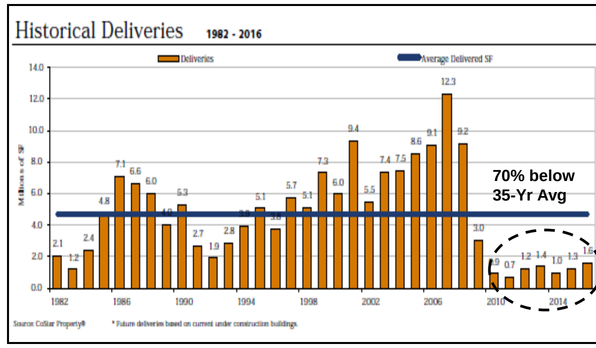
EverestHoldings

Phoenix Retail Continues to Improve, Despite Big Box Vacancies

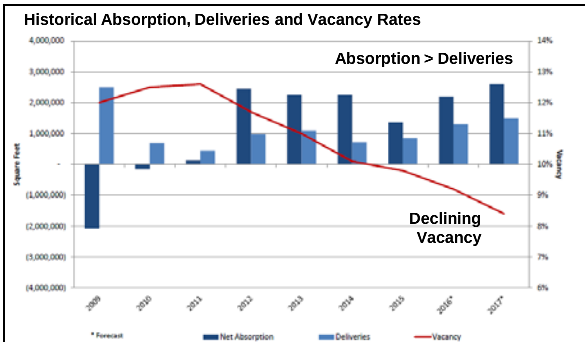
Recent Trends

The Phoenix retail market continues to improve, despite headwinds from big-box vacancies. As of Q2 2016, market vacancy was 9.1%. This compares to peak vacancy of over 12% in 2011. Although occupancy has improved steadily for several years, Q2 2016 was actually the first quarter since 2012 to record negative net absorption, albeit by a small amount, which was attributable to a few big-box vacancies. Rents, which bottomed in 2014 and started to increase in 2015, continued to rise during the first half of 2016 at a strong pace of 7% year-over-year. On the investment sales front, Phoenix sales volume YTD through Q2 was 63% higher in 2016 vs. 2015, due to higher both number of sales and pricing. This is in contrast to the 20% decline in retail sales volume experienced on a national level.



Market Impact

The Phoenix 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. For example, Phoenix saw 300,000 SF of big-box space vacated by Sports Chalet and the Roomstore during Q2 2016 alone, and more is expected as Sports Authority vacates several big-box locations starting in Q3 2016.

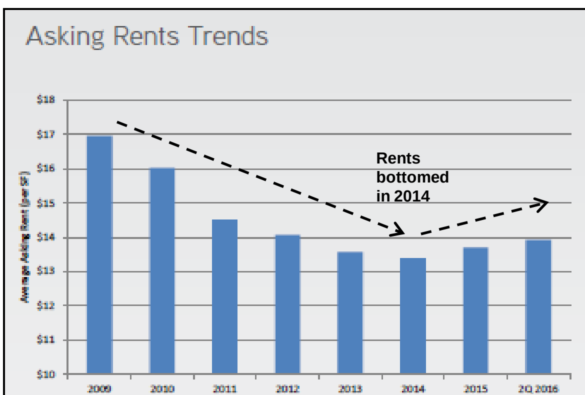


Source: Colliers

New retail supply in Phoenix has been extremely limited this cycle. Since 2011, the market has added only 5.6mm SF, while it has absorbed 10.6mm SF. On an annual basis, the average 1.3mm SF delivered per year over this period was over 70% below the long-term annual average of 4.5mm SF from 1982 to 2016. This lack of meaningful new supply should continue to drive higher market occupancy and rent growth for the foreseeable future.

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 only just recently begun to rise on a market-wide basis and, given the traditional lag between occupancy and rent, we expect retail rent growth to remain strong for several years.



Source: Colliers

Everest Insight

Two areas that have experienced increasing demand include the revitalized Grand Avenue Corridor and the area between Seventh Avenue and Seventh Street in central and midtown Phoenix. This is expected to continue as several value-add opportunities exist near up-and-coming multifamily developments along light-rail routes.

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