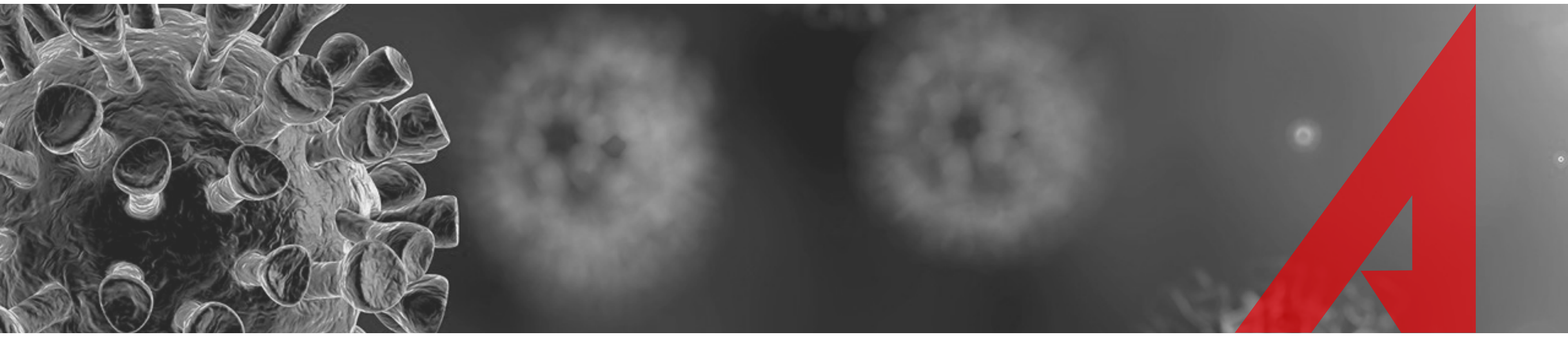
NAI Horizon

1st Quarter 2020 Retail Market Report



INTRODUCTORY OVERVIEW

Picking up the pieces. That's what we are doing. Where we go from here will depend on how well we pick up the pieces.

British writer Damian Barr recently posted on Twitter: "We are not all in the same boat. We are in the same storm." It is a storm we eventually will emerge from and everyone has the same question: when?

Perhaps the second biggest question that is on people's mind is whether we are entering a recession or a depression, to which Charles Schwab & Co, Sr. VP and Chief Investment Strategist Liz Ann Sonders wrote: "We may need a new descriptor this time – perhaps a 'screeching halt.' Even though we likely aren't yet in the teeth of the hit to the economy, the data through the first week of April was epically horrific."

She was principally referencing the rapid acceleration in jobless claims, yet there was also the survey of 18 investment firms and banks, the likes of which included Credit Suisse, UBS, JPMorgan, Goldman Sachs, Deutsche Bank and others, which predicted the decline in U.S. GDP for the second quarter would be in a range from negative 9.0% to negative 50%. The blended average was 22.48% negative GDP. Put in perspective, U.S. GDP declined 4% peak to trough over a span of six quarters during the 2008-2010 Great Financial Crisis.

The UCLA Zimon Center Director Stuart Gabriel is of the V-shaped recovery camp (a steep plunge to the bottom followed by a rapid bounce back), predicting second quarter GDP in the negative range of 30% to 40% and a third quarter negative GDP rate of 5% yet followed by growth in the fourth quarter. It's anyone's guess, and what we really want to know – will there be a football season?

RECESSION OR DEPRESSION?

In late March NAI Horizon brokers Don Morrow and Dylan Whitwer conducted a survey on the impact of COVID-19 to real estate markets, seeking the opinions of professionals from private capital, family offices, institutions and others. They published the results on April 20. Among other questions was: "How long will the current recession last?"

The optimists thought less than 3 months (3.9%) and three-to-six months (23.5%), while the middle-of-the-roaders thought 6 months to one year (37.3%), and the pessimists are expecting 1-to-2 years (27.5%) and longer than two years (7.8%).

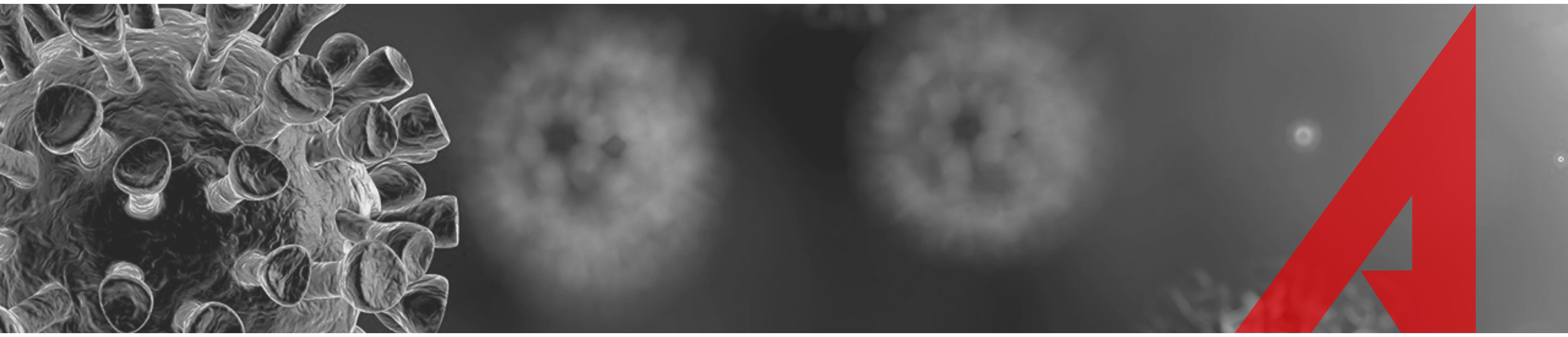
As a reminder, recessions are typically considered to be when two consecutive quarters of negative gross domestic product growth occurs, while an economic depression is widely considered to be when there is a decline in real GDP of 10% or a recession lasting two or more years. Another way to look at it is, as this report writer's father used to say: "A recession is when you are out of a job. A depression is when I am out of a job."

Back to Sonders from Schwab, among her long-term implications of the COVID Economy included "Deglobalization" as a force that is unlikely to recede and was already underway courtesy of the trade war and increased tariffs. We'll have more to say on this in the industrial report. Also, Corporate America was quick to respond to shelter-in-place orders particularly with regard to remote working, which may lead to a structural change in how they operate. The genie is out of the bottle on working from home, and we'll have more to say about this in the office report. Further, video conferencing is likely to replace some face-to-face meetings, especially the frequency of business travel, according to Sonders.

ARIZONA

Arizona jobless claims surpassed 418,000 during the third week of April, wiping out about two-thirds of employment gains over 10 years in the state in just five weeks, according to AZBIGMEDIA, many of which, as expected, were in hospitality and retail industries. From the depths of the recession in 2010, 631,000 jobs were added through the beginning of this year and in that recent five-week span, 418,016 Arizonans filed for unemployment.

However, R.L. Brown, the author of RL Brown Reports on Arizona's homebuilding and housing markets wrote on April 24: "It is certainly reasonable to assume that at the end of the day the Phoenix and Tucson housing markets



ARIZONA CONT.

could benefit from new populations and jobs leaving other areas in response to their trials and tribulations from the pandemic." In other words, the Great California Exodus will accelerate as people leave dense urban areas due to germ fear or sadly, because they simply cannot afford to live in the Golden State anymore – especially if they lost their jobs.

As for Phoenix-area commercial real estate, the data in these reports reflect the entire quarter ending March 31, yet the reality is that activity was pretty normal up until late February and then, the freeze. This is true for industrial, office and retail sectors -- deals that were close to closing, closed, while others were suspended. Currently, there is widespread sentiment of "let's wait and see" yet at the same time, like all changing markets, there is and will be opportunities in this downturn. We could not separate the leasing data by month but suffice it say most of the positive results happened in the first eight weeks of the year.

For investment real estate, lenders have largely put down their pencils down, and illiquidity could become an issue if the situation doesn't change soon.

In terms of recovery, while it is imminent, it is likely to be slow. Too many industries have been impacted by the COVID Economy, too many jobs lost, with many, many bankruptcies certain to follow. On a mid-April Bisnow Zoom call featuring Phoenix Mayor Kate Gallego, the former city councilwoman and earlier in her career, economic development director, shared that Sky Harbor Airport was on track to set a record in March for the most passengers in one month ever, and instead saw a drop in passenger traffic by 95%. The airport is the biggest income generator for the city's General Fund and already Phoenix has slashed its budget $26 million (in perspective, the city did $200 million in budget cuts in the last recession). Mayor Gallego said on the call that she doesn't expect to return to the Pre-COVID passenger traffic counts until 2023.

Yet, it's not all gloom and doom. As Arizona Gov. Doug Ducey recently stated, "Arizona was leading in economic momentum heading into the downturn, and Arizona will lead the way out." Businesses are starting to re-open, and tourism will return (try testing the resolve of traveling golfers, snowbirds and sun lovers!). It is not Pollyannaish to believe that Arizona will rebound faster than many states. In addition to proximity the California, the NAFTA Highway runs right through the state to Mexico, and Arizona has greatly diversified its economy in the last 10 years, even being dubbed "Wall Street West' for all of the financial institutions with a presence in Arizona. The state will be a net beneficiary when the U.S. reinvents its supply chain and "re-shores" many of those business functions back to North America from Asia.

As for managing the virus itself, we are all anxiously waiting for successful therapeutics and ultimately, a vaccine.

A note to readers: the overviews to all three of our first quarter reports on office, retail and industrial are the same for each report. The intention is to provide an overview of economic conditions before getting into the details of each property sector, because what happens next with the economy will determine what happens in commercial real estate. So if you read the introduction once and intend to read another report, skip down to find the new content in each report.

Q1 2020 | RETAIL MARKET METRO PHOENIX

OVERVIEW

The slow down in the economy due to the spread of the coronavirus in the United States has been nothing short of brutal on retailers. Most of the first-quarter damage was rendered in March, as transaction velocity during the first two months of the year remained strong and then within a week or two ground to a halt as Arizona, along with the rest of the country, in an effort to slow the spread of COVID-19. The second quarter is likely to continue with this static state.

Big box retailers and department stores have already had a rough ride for the last 3 or 4 years, with the number of big box retailers that are downsizing or closing, outpacing the number of retailers that are expanding. This pandemic could prove to be the final factor that pushes some of those businesses that were on the brink of being profitable, into closure or reorganization.

Macy's is expected to close 125 U.S. stores this year. Neiman Marcus recently filed for bankruptcy (Chapter 11, it will almost certainly reemerge, leaner), J.Crew Group Inc. also filed for bankruptcy as it is saddled with $1.7 billion in debt, according to a Wall Street Journal story. J.C. Penney is expected to file for bankruptcy protection. Hedge-fund owned Sears could be next.

The Phoenix regional risk exposure from some of these department stores includes the following:

- Neiman Marcus - 1 store
- J.Crew - 2 stores
- Sears - 4 locations
- J.C. Penney - 8 stores
- Macy's - 8 locations

Depending on the source, forecasters are saying 20 percent or more restaurants could fail. It remains to be seen if restaurants can be profitable with the drastic cuts to seating capacity that some government entities are proposing in order to maintain social distancing. The main hope for many of the upper end restaurants in the region is as they do reopen, Phoenix's foodie culture and 2 months of pent-up demand will help support them.

Shopping centers and related retail estate development projects already under construction remain under construction, which has been considered an essential business during the lockdown. It remains to be seen, if these projects will see any setbacks due to lack of continued construction financing.

New retail development projects that are still in the planning stages, are extremely unlikely to move forward. Lack of demand and securing financing are the two main issues.

Movie theater chains are also under dire threat to survive. Closure, followed by delayed reopening and particularly, consumer demand, are problems. To complicate matters, some Hollywood studios have experimented with releasing their movies directly to the public and bypassing the traditional period where the movie would be offered exclusively in theaters. With some theaters striking back and threatening to blackball future offerings from those studios going direct to the consumer, it's unclear how the future will shape up for the movie theater industry.

Harkins Backlot has submitted approval paperwork with the City of Chandler to open a 64,500 square foot theater, bar, restaurant, laser tag, arcade games, bowling and party rooms on the second floor of the former Sears location at Chandler Fashion Center. It remains unknown if the entertainment operator intends to follow through and build out the space and open later this year. Harkins Theaters is family owned and operated since 1933, when the family opened Tempe's first movie house. Today, Harkins has over 500 screens in the region.

1ST QUARTER DATA - DEVELOPMENT & ABSORPTION

In the first quarter 342,754 square feet of new retail inventory was delivered to the Phoenix metro area. That compares with 395,013 square feet in the fourth quarter last year and 281,619 square feet in the first quarter 2019. The high watermark in this cycle for new product deliveries was the third quarter 2016 when 932,200 square feet of new stores, shops and shopping centers were completed.

First quarter net absorption was extremely flat, with 17,250 square feet of positive net absorption. That compares with 420,036 square feet in the fourth quarter last year and 75,344 square feet of positive net absorption in the first quarter 2019.

Q1 2020 RETAIL MARKET METRO PHOENIX

VACANCY & RENTAL RATES

The market-wide retail real estate vacancy rate closed the first quarter at 7.0 percent. As we have written in previous reports, the vacancy rate has hovered in that range for two years now. It was 7.1 percent at the end of the first quarter 2018 (the 'high') in this 8-quarter span, with the low coming in at 6.7 percent at the end of the third quarter 2018. That is a market in equilibrium, and it is about to change. Ten years ago it was 12.2 percent (1Q2010) and reached a high point in the past decade at 12.6 percent in the first quarter of 2011. The vacancy rate is bound to spike higher. By how much is anyone's guess? Obviously, it depends on how shallow or deep the recession is, and that assumes we have one. Los Angeles-based Beacon Economics recently published the most optimistic report we've seen in recent weeks and is forecasting a steep 'V' to the economic collapse and recovery, meaning a forecast of negative -30 percent GDP in the second quarter this year and then a big bounce with positive GDP of 25 percent in the third quarter, followed by a 5 percent GDP gain for the final quarter this year.

Average asking retail rental rates ended the first quarter at $15.94 per square foot, compared with $15.90 per foot in the closing quarter last year and $15.65 a foot in the first quarter 2019. Asking rents were higher a decade ago, at $16.85 per square foot at the close of the first quarter 2010 then declined to a low point of $13.77 per foot in mid-2015. Average asking rents have inched upward since then.

SIGNIFICANT RETAIL TRANSACTIONS

In late January Consolidated-Tomoka Land Co. acquired Crossroads Towne Center in Chandler from investment firm Vestar for $62 million. The 254,000 square foot shopping center was 99 percent leased at the time of the sale. Located at 3757 S. Gilbert Road just south of the Santan freeway, the asset is shadow anchored by Home Depot and Wal-Mart. The 12-screen Harkins Theaters and Bob's Discount Furniture were also not part of the sale yet are major co-tenants at the shopping center. Consolidated-Tomoka Land Co. is based in Daytona Beach, FL.

A retail property at 4414 Cactus Road (on the NW corner of 43rd Avenue) sold in late February for $9.75 million. Phillips Edison & Co. sold the 60,000 square foot asset to Mimco Inc.

In March, a 35,000 square foot car dealership traded hands on E. Bell Road in Phoenix. The asset, known as Big Two Mitsubishi, sold for $9 million. Courtesy Chevrolet bought it from Toyota Scion of Chandler.

STORE RE-OPENINGS & OTHER GLIMMERS OF HOPE

Arizona population growth is likely to accelerate in this recession. Already the fastest growing state in the U.S., we should expect more Californians to move here. In late April, renter search data compiled by Apartment List, revealed that 33 percent of rental apartment searches in Los Angeles were searches in other cities, and Phoenix garnered 22 percent of those searches. Remember, 'rooftops drive retail'.

In a 'Tale of Two Cities' manner, Scottsdale retail and Tempe retail, particularly locations near ASU, will likely be less impacted by the recession, because of the discretionary income of many of Scottsdale's residents and the population density near the college campus.

Simon Property Group reported at the end of April that it would reopen 49 malls and outlet centers in states loosening stay-at-home restrictions in states such as Georgia, Texas, Oklahoma, South Carolina, Tennessee and Indiana. That means it is likely Simon Property's three retail assets in the region – Arizona Mills in Tempe, Phoenix Premium Outlets in Chandler and Tucson Premium Outlets in Tucson, should open soon. The Indianapolis-based company, the largest operator of malls and shopping centers in the U.S., temporarily closed the three Arizona centers on March 18, the day after the shelter-in-place order was declared in the state. A spokesperson for Simon said the reopened centers would do so with limited hours and shoppers could pick up free masks at on-site management offices.

Macy's announced it would open 68 stores on May 4th in select states and a second batch of 50 stores on May 11th, and hopes to reopen all 775 stores within six weeks, about a quarter of which are in Simon Property Group malls.

As we continue to endure the effects of the shutdown and new social distancing requirements we are seeing retailers continually adjusting their business models to remain profitable in this new economic climate. Restaurants and retail stores are offering expanded curbside pick up and delivery, fitness providers are offering streaming classes allowing members to exercise from the safety of their own home,others are adapting in whatever way possible to retain their customer base. Unfortunately, only time will reveal the full impact of COVID-19 and the what the road to recovery for Phoenix retail, and the U.S. economy as a whole, will entail.

Q1 2020 RETAIL MARKET METRO PHOENIX

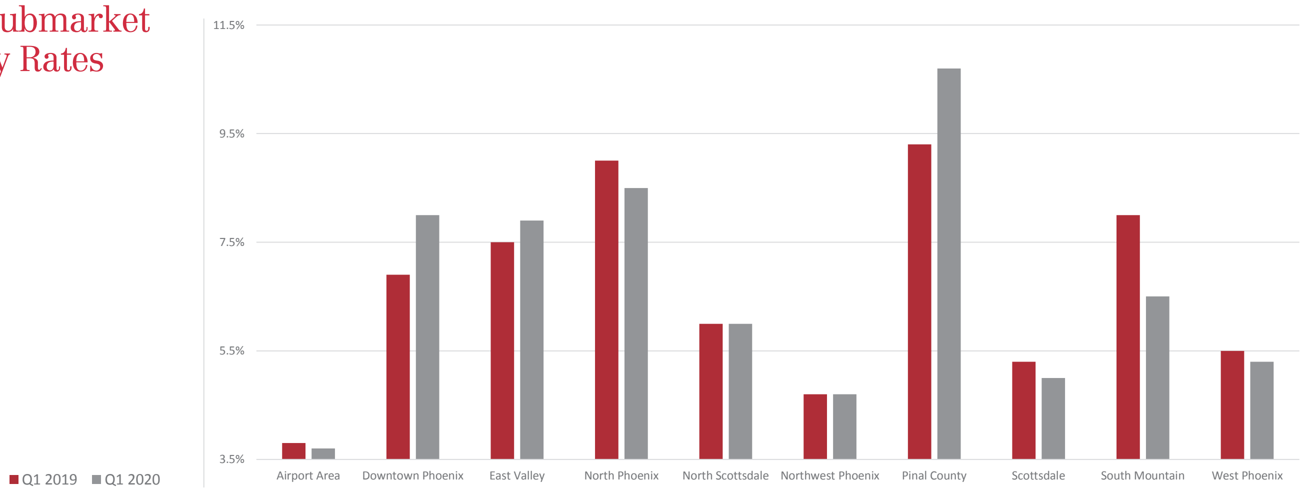
Phoenix Market Snapshot

Market Overview	Total RBA	Vacant SF	Vacant %	Net Absorption	RBA Under Construction	Average Rental Rate
Power/Lifestyle	33,949,697 SF	1,955,602 SF	5.8%	(58,128) SF	167,389 SF	$27.46 NNN
Regional Mall	15,355,902 SF	1,318,986 SF	8.6%	202,256 SF	-	$10.00 NNN
General	74,220,814 SF	3,043,709 SF	4.1%	(51,042) SF	281,363 SF	$19.39 NNN
Shopping Center	108,961,575 SF	10,051,050 SF	9.2%	(206,230) SF	412,918 SF	$14.68 NNN
Overall Total	232,487,988 SF	16,369,347 SF	6.9%	(113,144) SF	861,670 SF	$17.88 NNN

Significant Lease Transactions	City	Tenant	Size	Submarket	Type
245 N Bell Rd	Phoenix	Roadhouse Cinemas	47,527 SF	East Phoenix	Move In
1004 N Promenade Pkwy	Casa Grande	New Furniture Outlet	30,000 SF	Outlying Pinal Cty	Move In
5455 E Carefree Hwy	Cave Creek	Sprouts	29,896 SF	Anthem	Move In
3636 W Southern Ave	Phoenix	Skyzone Trampoline	24,000 SF	Tolleson	Move In
4844-4902 S Val Vista Dr	Gilbert	Planet Fitness	23,845 SF	Gilbert	Move In

Significant Sale Transactions	Address	Date	Size	Sale Price	Price/SF
Crossroads Towne Center	2840-2889 E Germann Rd	1/24/2020	67,633 SF	$15,680,867	$231.85
Crossroads Towne Center	2980 E Germann Rd	1/24/2020	55,737 SF	$12,922,752	$231.85
Crossroads Towne Center	2670 E Germann Rd	1/24/2020	42,411 SF	$9,833,088	$231.85
Cactus Village	4312-4414 W Cactus Rd	2/28/2020	60,363 SF	$9,750,000	$161.52
Gateway Village	5906-6080 W Bell Rd	1/27/2020	98,598 SF	$9,071,671	$92.01
Raintree Shops	14884 N Pima Rd	1/16/2020	21,465 SF	$9,050,000	$421.62

Retail Submarket Vacancy Rates



The Retail Market is a compilation that includes general retail, regional mall, power and lifestyle centers and shopping center buildings. Some information contained herein has been obtained from third party sources deemed reliable but has not been independently verified by NAI Horizon. NAI Horizon makes no warranties or representations as to the completeness or accuracy thereof. NAI Horizon makes no guarantee about projections, opinions, assumptions or estimates. Occasionally corrected or updated information becomes available for both current and historical data thereby invalidating specific comparison to previously issued reports.

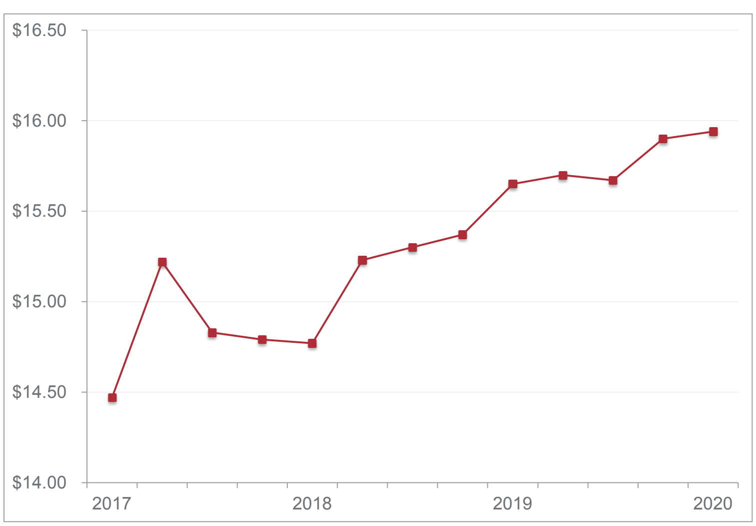
Q1 2020

RETAIL MARKET METRO PHOENIX

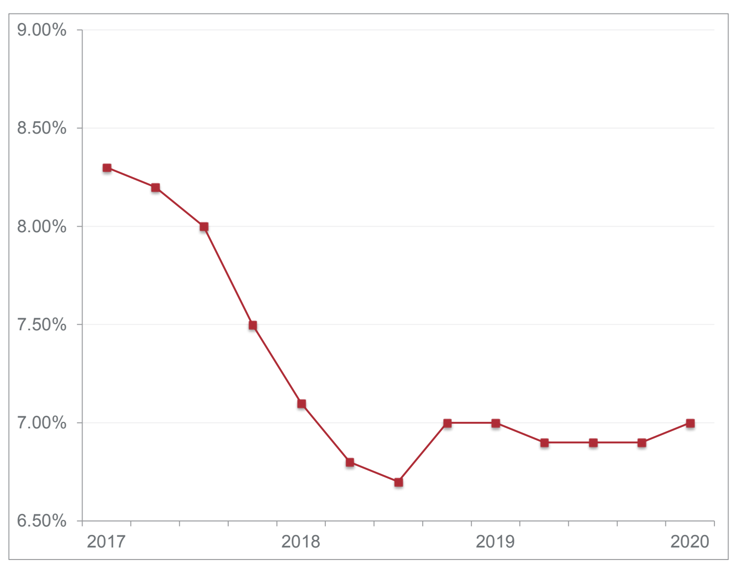
Submarket Snapshot

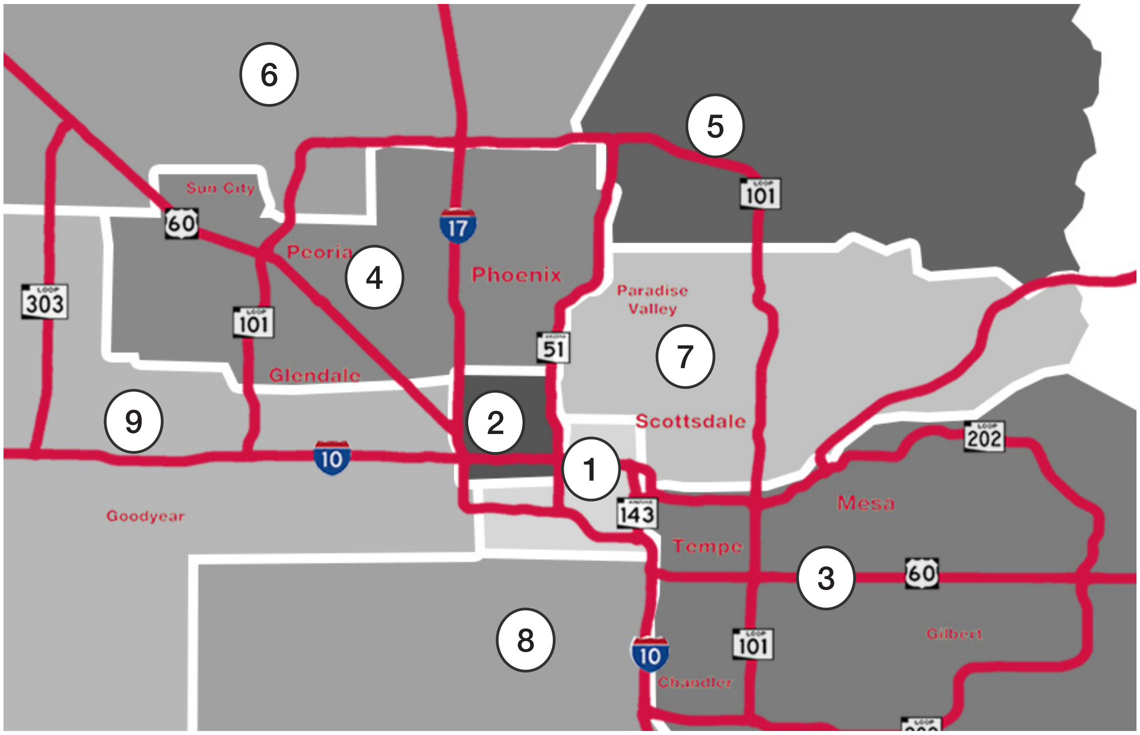
	RBA		Vacant SF		Vacant %		Net Absorption		Under Construction		Avg NNN Rate	
Airport Area	5,598,856	—	204,735	▲	3.7%	▲	(16,866)	▼	-	▼	$17.08	▲
Downtown Phoenix	7,643,292	▼	613,439	▲	8.0%	▲	(50,936)	▲	46,449	—	$21.78	▲
East Valley	77,777,786	▲	6,146,069	▲	7.9%	▲	264,002	▲	526,056	▼	$15.06	▲
North Phoenix	40,409,008	▲	3,441,834	▲	8.5%	▲	(39,832)	▼	25,832	▼	$12.73	▼
North Scottsdale	18,307,184	—	1,091,855	▲	6.0%	▲	(44,004)	▼	8,355	▲	$20.90	▼
Northwest Phoenix	20,644,335	▲	971,305	▲	4.7%	▲	12,030	▼	76,724	▼	$16.58	▲
Pinal County	10,824,144	▲	1,159,321	▲	10.7%	▲	(360,356)	▼	20,342	▼	$12.51	▼
Scottsdale	19,835,827	▲	986,948	▼	5.0%	▼	302,492	▲	120,639	▼	$25.12	▲
South Mountain	6,864,593	▲	443,305	▲	6.5%	▲	4,926	▼	-	▼	$18.54	▲
West Phoenix	24,582,963	▲	1,310,536	▲	5.3%	▲	(68,344)	▼	37,273	▲	$15.38	▲
All Submarkets	233,299,629	▲	15,497,227	▲	6.6%	▲	17,250	▼	861,670	▼	$15.94	▲
Overall Total 4Q19	232,927,445	▲	15,436,224	▲	6.6%	▲	420,036	▲	1,093,687	▼	$15.90	▲
Overall Total 3Q19	232,581,588	▲	15,355,004	▼	6.6%	▼	214,930	▼	1,160,094	▼	$15.67	▲
Overall Total 2Q19	232,382,836	▲	15,448,915	▼	6.6%	▼	220,277	▼	1,323,341	▼	$15.70	▲

Rental Rates



Vacancy Rates





Retail Submarkets

1. Airport Area
2. Downtown Phoenix
3. East Valley
4. North Phoenix
5. North Scottsdale
6. Northwest Phoenix
7. Scottsdale
8. South Mountain
9. West Phoenix

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NAI Horizon knows commercial real estate. With over 27 years in the Valley, NAI Horizon's extensive market insight allows us to match client needs with the right solutions. NAI Global member firms span the U.S. and 36 other countries, with more than 375 offices and more than 6,000 local market experts on the ground. Supported by the central resources of the NAI Global organization, member firms deliver market-leading services locally, and combine their in-market strengths to form a powerful bond of insights and execution for clients with multi-market challenges.

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