



NAI Horizon

1st Quarter

2021

Retail
Market Report

Economic Overview

The Recovery is Well Underway

The economic recovery underway in the U.S. can be summarized in three words: pent up demand. With the exception of jumping on a Zoom call, there is pent up demand for everything. Going to restaurants, a ballgame, on a vacation (and one that requires air travel), going back to the office. You name it. Look at Phoenix traffic during commute hours. To use a non-technical phrase, it sucks. Again.

Here are just three headlines in one newspaper on one day in mid-April:

“Oil Demand Recovers Amid Vaccine Hiccups”
“Logjam of Cargo Ships Ease at California Ports”
“Oil Demand Recovers Amid Vaccine Hiccups”

West Texas Intermediate Futures, the U.S. gauge for oil demand (vs. Brent Crude, globally), jumped 4.6 percent in a day when this report was being written, to close at \$63.15 a barrel. A year ago that barrel of oil was trading at its lowest point in 10 years, at \$16.52. See the retail and industrial reports for details from those other two headlines.

With stock markets still breaking records and banks reporting very strong earnings, it's beginning to look like Alan Greenspan's "Goldilocks Economy," which the former Federal Reserve Chairman popularized in the late 1990s, though he was not the first banker to use the phrase to describe a sustainable economy that is not too hot or too cold, and features low inflation.

With nearly 200 million Americans inoculated, doctors doom and gloom appear wobbly and on the ropes, while Captain Confidence is taking control of the narrative.

The Recovery is Well Underway

At the close of 2020, jobs in Arizona were 3 percent below their February 2020 peak and represented a substantial 90,100 job gap, over half of which were in leisure and hospital sectors of the state's economy, as the travel and tourism industry remained hard hit by the pandemic. Further, in December, all major employment sectors, with the exception of transportation and warehousing, were below their peak. Income growth in the state surged in the second and third quarters of 2020, driven upward by a gigantic flow of federal relief funds into the state that helped to stabilize the economy in general and spurred gains in retail sales of tangible goods and trade, transportation, and warehousing jobs in particular.

Ongoing population growth and demand for housing remained high throughout the pandemic

Arizona total housing permits rose 23.0% in 2020 to 57,281. That was up from the revised 2019 annual total of 46,580. Most of the increase was driven by single-family activity, which rose to 41,465. That was an increase of 22.0%. Multi-family permits rose 25.5% to 15,816 in 2020.

Phoenix MSA housing permits increased 27.4% to 45,694 in 2020. Single-family permits increased to 31,475 (up 25.8%) and multi-family permits rose to 14,219 (up 31.1%).

Tucson MSA housing permits also increased last year, but at a slower pace. Total permits rose 14.9% to hit 4,956. Single-family permits accounted for all of the increase, rising 21.6%. Multi-family permits dropped 13.3% in 2020.

Economic Overview continued

The house prices indexes from the Federal Housing Finance Agency (FHFA) measure repeat sales on single-family homes, and thus are not impacted by composition effects that can distort trends in median house prices. Data for the third quarter of 2020 also indicate strong house price appreciation in Arizona, with prices up 7.9% over the year statewide, 8.3% in Phoenix, and 7.2% in Tucson. By comparison, nationally, house prices were up 4.7% over the year in the third quarter.

We'll report on travel and tourism data in a future market report this year, but suffice it to say late winter and early spring travelers returned to Arizona in droves in recent months, and with it came a nice bounce in that sector of the state's economy – both in terms of hiring and spending.

(Sources: Saudi Aramco, The Wall Street Journal, Economic and Business Research Center, The University of Arizona's Eller College of Management).

RETAILERS DEMONSTRATE RESILIENCE AND INNOVATION AS RETAIL RECOVERY GAINS STEAM

The pandemic has impacted the retail industry and retail real estate unevenly. The global health crisis accelerated the shift to e-commerce or at least accelerated the growth of e-commerce, with online retail sales in the U.S. increasing in 2020 by nearly one-third to \$795 billion, according to research firm eMarketer. This shift has hurt non-branded, 'mom and pop' retailers in strip centers as well as large, enclosed malls and entertainment venues that rely on crowds gathering and mingling.

The small, locally owned businesses that survived by being creative and adapting their business models are starting to recover as the Phoenix metro area reopens. Some larger retailers succeeded by pivoting to Amazon-style fulfillment centers. An example is Target, which is now reporting that it costs approximately 40 percent less to ship from its stores than it does its warehouses. Research firm IHS Markit reports that e-commerce accounted for 21.2 percent of retail sales in 2020, compared with 18 percent at the end of 2019.

Others, like Nordstrom, are introducing 25,000-square-foot storefronts, or showrooms, to display limited merchandise (instead of a 100,000-square foot store) and then using fulfillment methods to deliver purchases to its customers.

Kohl's is allocating nearly \$650 million this year to cover the costs of its new partnerships with companies like Sephora and Amazon. Kohl's announced that they would be partnering with beauty products seller Sephora to create Sephora branded areas inside approximately 200 Kohl's locations by the end of 2021. Kohl's has also been working with Amazon to create new customer service centers under the retail giant's roof, as part of Amazon's push to diversify the shipping and distribution aspects of its operations.

Thus far the Kohl's at Mesa East (1632 S Signal Butte Rd – Superstition Gateway Plaza), and South Peoria (9220 W Northern Ave - Peoria Crossings Plaza) are the only Arizona stores with Sephora at Kohl's locations.

Similarly, Target has teamed up with Ulta Beauty to put Ulta stores within existing Target properties. Target and Ulta are introducing 100 such concepts nationwide in 2021.

GROCERS STILL IN THE HUNT

With shutdown orders and reduced capacity rules limiting indoor, sit-down dining, supermarkets and grocery stores posted record sales numbers last year. Grocery sales increased 11 percent in 2020 – more than triple the growth of the previous two years, according to data from the U.S. Census Bureau.

Grocers are still in the hunt for locations. Phoenix-based Sprouts Farmers Markets Inc. plans to open 20 new stores this year, including Sprouts @ Sonoran Creek Marketplace in the town of Maricopa. Sprouts is also working on plans to streamline and upgrade its shopping experience, including opening smaller stores and carrying more plant-based and frozen products that have been top sellers in existing stores

ALDI, a discount chain mainly in the Midwest and with stores typically ranging from 20,000 square feet to 28,000 square feet, opened its fourth Arizona location in February (in Gilbert) and has more locations in the works. The grocer has opened three other stores in the Phoenix metro -- Chandler, Goodyear, and Peoria. They are in various stages of the development process with building applications and plans filed in multiple cities across the valley including Buckeye, Phoenix, Queen Creek, Scottsdale, and Tempe.

Whole Foods has committed to being part of the mix at the redeveloped Paradise Valley Mall near affluent Paradise Valley and Scottsdale. Owner Macerich – a REIT, and the third-largest operator of shopping centers in the U.S., is doing a massive overhaul of the struggling, 1970s-era mall by recreating the venue as a mixed-use property. Up to 2,500 apartments and condos are being added, along with shops, restaurants, and self-storage facilities. The existing Costco and perimeter pads will remain and will stay open during construction.

DRIVE-THRU BOOM

The pandemic has also fueled growth for drive-thru-focused, up-and-coming concepts like Dutch Bros, Salad & Go, as well as perennial retail powerhouse Starbucks. Salad & Go opened 6 new locations throughout the valley during the pandemic, including Signal Butte Rd & Guadalupe Rd in southeast Mesa, McClintock Dr & Elliot Rd in south Tempe, and Pecos Rd & Val Vista Dr in Gilbert, all of which were constructed in the first quarter of 2021. Salad & Go doesn't look to be done yet – they have 4 locations set to deliver in the summer of 2021 throughout the Valley, including one in mesa, one in Peoria, and two in Phoenix. Dutch Bros Coffee (which also tends to run its business out of sub-one-thousand SF shops) isn't far behind them; during the pandemic they've added four additional locations (with two more on the way) to keep up with booming demand. Starbucks has also added 7 locations since 2020, with all but one having a drive-thru component. Aside from those three standouts, names like Burger King, Chick-Fil-A, Chipotle Del Taco, Culver's, McDonald's, Someburros, Raising Cane's, and Black Rock Coffee have either added or are set to add multiple drive-thru locations by the end of this year.

A NOTE ABOUT LUXURY BRANDS

Pent up demand for luxury brands, which is often driven by travel and tourism, is giving cause for cheer in that sector of the retail economy. The world's biggest luxury company, LVMH Moët Hennessy Louis Vuitton reported a spike in first quarter sales of 30% more than the same quarter a year earlier – impressive year-over year growth considering the pandemic was not in play until the middle of March 2020. While it is too early to declare a full recovery for sales of fancy handbags and related luxury goods, thus far the sector has defied dire predictions of a slow, protracted comeback.

THE VALLEY OF THE SUN'S SEEMINGLY INSATIABLE APPETITE FOR RESTAURANTS

Activity on available retail space in Phoenix has picked up substantially in recent months. Demand is growing for previously occupied restaurant locations (often called 'second-generation space') between 3,000 square feet and 5,000 square feet.

Fox Restaurant Concepts (Blanco Tacos + Tequila, Culinary Dropout, Flower Child, Zinburger and others) keeps them coming, and now operates in 12 states in addition to Arizona. A new Flower Child as well as a North Italia have been announced at Santan Village Parkway and E. Williams Road. Author and Edit Hospitality, a hospitality collaborative with Sam Fox at the creative helm, has a boutique hotel under construction at 44th Street and Camelback Road. Slated to open in 2023, the 141-room Global Ambassador hotel "will inspire and draw travelers from all over the world to explore Phoenix in a new way," Fox said in a statement. The resort will feature five restaurants, including a 18,000-square-foot rooftop restaurant that will enjoy panoramic views of Camelback Mountain.

Arizona is one of 26 states with the newest creation from Guy Fieri and his Flavortown Kitchen operation, which operates 'ghost kitchens,' or virtual restaurants, that take up space inside existing restaurants and offer delivery-only meals. In January and February the entrepreneur and food entertainer opened four Buca di Beppo restaurants locally -- in Chandler, Mesa, Peoria and Scottsdale.

1ST QUARTER DATA

Fueled by strong first quarter absorption of retail space, overall (total) retail vacancy in the first quarter declined to 7.4 percent, from 7.7 percent at the end of last year and is almost back to where it was at the onset of the pandemic (it was 7.1 percent at the end of 1Q2020). Absorption was net positive for the first three months of 2021 by a sizeable 994,906 square feet, led by the East Valley submarket, with 431,030 square feet, and followed by the Northwest Phoenix submarket, with 239,615 square feet of positive net absorption.

The East Valley, with its high concentration of suburban homes and neighborhoods in San Tan Valley, Queen Creek and Chandler Heights, is driving demand for retail real estate.

By comparison, net absorption was 187,662 square feet in the first quarter of 2020. The market has not seen this much positive net absorption since 2018 and the second half of 2017, when three quarters exceeded 1 million square feet and one quarter (2Q2018) had 906,709 square feet of net absorption.

Not a single submarket in Metro Phoenix (out of 10) had negative net absorption in the first quarter.

Regional malls are suffering the highest vacancy rates, at 14.8 percent on average, compared with shopping centers (9.3 percent), power/lifestyle centers (5.7 percent) and general retail at 4 percent.

Overall asking rents averaged \$15.66-per-square-foot (psf) for the quarter, up a few pennies from the fourth quarter (\$15.62 psf) with Scottsdale leading the pack on asking rents at \$23.24 and North Scottsdale at \$20.08.

Developers delivered 321,452 square feet of new inventory in the first quarter and had 648,946 square feet of new retail product under construction at the end of March, compared with over 1.1 million square feet in the fourth quarter last year.

TOP LEASES

The biggest leases in the first quarter were all local operators that provide a range of essential merchandise and experiences, including fitness, hardware and appliances, and education.

Scottsdale Gymnastics leased 38,000 square feet on E. Shea Blvd. in the central Scottsdale submarket, while ACE Hardware took 20,000 square feet on E. Florence Blvd. in Casa Grande. Aaron's Rents, a rent-to-own retailer offering furniture, appliances and electronics with 11 existing stores in the Phoenix area, leased 20,000 square feet also on E. Florence Blvd. in Casa Grande.

Paradise Appliances took a little more than 17,000 square feet at Mesa Pavilion North on Hampton Avenue and Ridgeline Academy was the fifth largest lease in the first quarter, by committing to a nearly 15,000-square-foot space on the first floor of a four-story mixed-use building in Legacy Commons (Phoenix) on N. 41st Street.

BIGGEST SALES

At the end of the first quarter, Spirit Realty Capital Inc. out of Dallas was in the process of buying an 180,000-square-foot health club building in Peoria for \$34 million. The property is occupied by Life Time Fitness and the seller was LTF Real Estate Company Inc., based in Eden Prairie, MN.

Another large transaction in escrow, involved a 41,232-square-foot retail building in Avondale for \$15.8 million, or \$383 per foot. Medford, OR-based Lithia Real Estate Inc. is buying the asset from locally based Pierce Automotive.

Westpoint Homes of Moore, OK bought a portion of a storefront building measuring 78,834 square feet that is part of a multi-property asset for \$11.99 million, or \$152 a foot, from LNR Partners LLC, based in Miami, FL. The asset is on E. Bell Road in Phoenix's Moon Valley Towne Center.

The final notable sale (in progress) involves a very large portfolio, and is worth noting because it is part of the pandemic story and indicative of the transformation underway in the retail world. JC Penney Company Inc., based in Plano, TX, sold its department store in Glendale's Arrowhead Towne Center to GLAS, based in Jersey City, NJ. The 146,653-square-foot building is trading at \$77-per-square-foot for a total of \$11.3 million. The venerable, 118-year-old retailer that was founded in Kemmerer, Wyoming filed for Chapter 11 bankruptcy protection last summer and within months was acquired by Simon Property Group and Brookfield Capital Partners. While JC Penney owned its real estate, Simon and Brookfield bought the company because in many of their respective shopping centers, JC Penney is one of the primary anchor tenants and both investors are believed to have felt that without that anchor in place it would impact the vibrancy of their shopping centers, reduce traffic to them and lower rental rate structures with the rest of the tenants in those shopping centers. It is typical for shopping mall rates to be based on traffic generated by anchor tenants. With the anchor, landlords get more per for foot from smaller tenants and without them, less. Penney's bankruptcy affected 160 of its stores as well as warehouses and distribution centers the company owns. The two entities associated with the stores and warehouses are expected to emerge from bankruptcy the first half of this year. Simon and Brookfield are already operating the stores under its original namesake.

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RETAIL MARKET METRO PHOENIX

Phoenix Market Snapshot

Market Overview

	Total RBA	Vacant SF	Vacant %	Net Absorption	RBA Under Construction	Average Rental Rate
Power/Lifestyle	33,955,284 SF	1,925,212 SF	5.7%	14,840 SF	-	\$19.43 NNN
Regional Mall	15,269,821 SF	2,258,866 SF	14.8%	(12,961) SF	13,197	\$10.24 NNN
General	76,032,088 SF	3,055,881 SF	4.0%	446,775 SF	232,530 SF	\$17.43 NNN
Shopping Center	108,287,486 SF	10,031,856 SF	9.3%	539,752 SF	403,219 SF	\$15.02 NNN

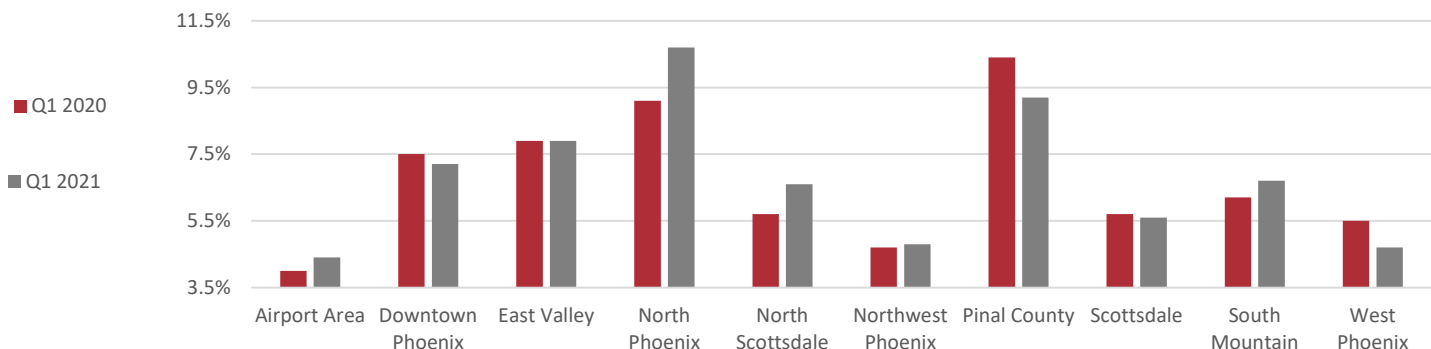
Significant Lease Transactions

	City	Tenant	Size	Submarket	Type
8658-8666 E Shea Blvd	Scottsdale	Scottsdale Gymnastics	38,000 SF	Central Scottsdale	Move In
1321-1325 E Florence Blvd	Casa Grande	ACE Hardware	20,000 SF	Outlying Pinal Cty	Move In
5455 E Carefree Hwy	Mesa	Paradise Appliances	17,034 SF	Red Mountain Mesa	Move In
3636 W Southern Ave	Phoenix	Ridgeline Academy	14,872 SF	North I-17	Move In
9375 W Coyotes Blvd	Westgate	Sugar Factory	12,314 SF	Glendale	Move In

Significant Sale Transactions

	Address	Date	Size	Sale Price	Price/SF
Life Time Fitness Peoria	24700 N 67th Ave	3/15/2021	180,000 SF	\$34,000,000	\$188.89
Avondale Nissan	10305 W Papago Fwy	3/25/2021	41,232 SF	\$15,800,000	\$383.20
JC Penny-Arrowhead Mall	7750 W Arrowhead Towne Center Dr	1/30/2021	146,653 SF	\$11,300,000	\$77.05
JC Penny-Superstition Springs	6525 E Southern Ave	1/30/2021	153,278 SF	\$10,400,000	\$67.85
JC Penny -Goodyear	13333 W McDowell	1/30/2021	97,513 SF	\$10,250,000	\$105.11
The Agave	14601 N Scottsdale Rd	2/26/2021	16,038 SF	\$9,775,000	\$609.49

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.

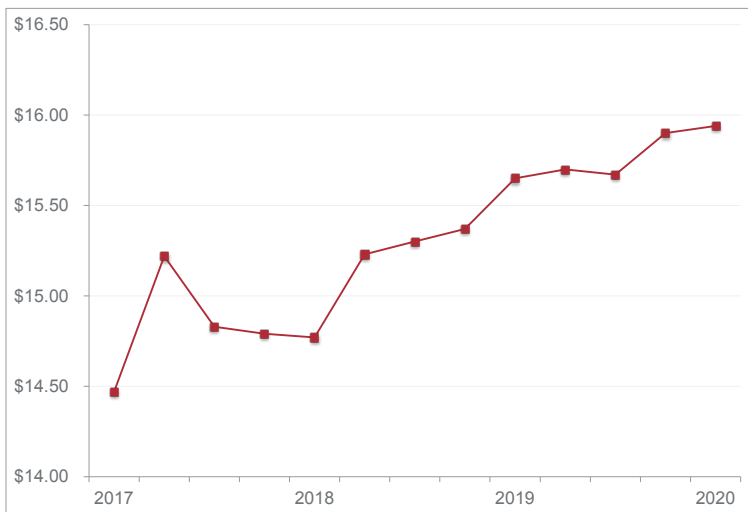
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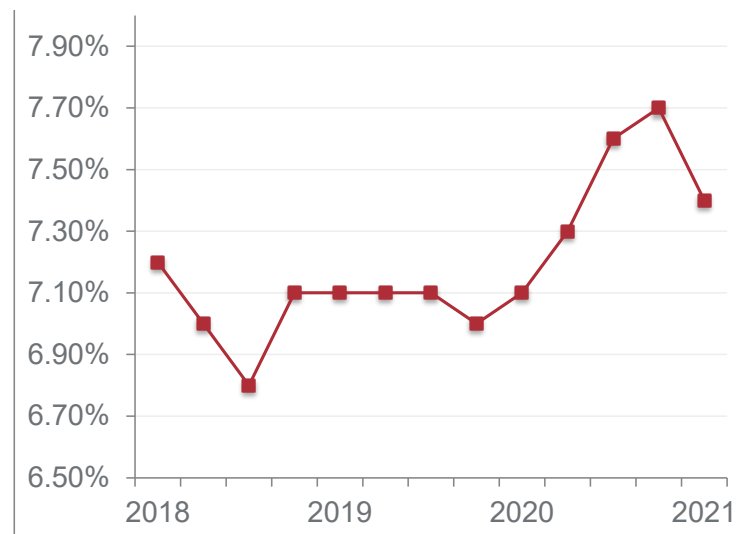
Submarket Snapshot

	RBA		Vacant SF		Vacant %		Net Absorption		Under Construction		Avg NNN Rate	
Airport Area	5,748,028	▲	254,663	▲	4.4%	▲	1,910	▲	-	▼	\$18.11	▲
Downtown Phoenix	7,867,322	▲	563,918	▼	7.2%	▼	24,515	▲	5,325	▲	\$17.51	▼
East Valley	77,961,714	▲	6,127,759	▼	7.9%	▼	431,030	▲	160,858	▲	\$14.77	—
North Phoenix	40,356,180	▲	4,305,670	▼	10.7%	▼	23,902	▲	64,250	▼	\$13.43	▲
North Scottsdale	18,055,483	—	1,183,230	▼	6.6%	▼	53,269	▲	-	—	\$20.08	▲
Northwest Phoenix	21,013,284	▲	1,084,800	▼	5.2%	▼	239,615	▲	53,153	▼	\$17.34	▲
Pinal County	10,965,249	▲	1,006,346	▼	9.2%	▼	113,536	▲	107,072	▲	\$12.36	▲
Scottsdale	19,877,743	▲	1,106,262	▼	5.6%	▼	67,821	▲	67,000	▼	\$23.24	▲
South Mountain	6,809,913	—	454,730	▲	6.7%	▼	13,732	▼	-	—	\$18.15	▼
West Phoenix	24,853,681	—	1,184,437	▼	4.8%	▼	19,076	▼	191,288	▲	\$16.14	▼
All Submarkets	234,372,736	▲	17,290,549	▼	7.4%	▼	994,906	▲	648,946	▼	\$15.66	▲
Overall Total 4Q20	234,065,333	▲	18,009,385	▲	7.7%	▲	161,644	▲	790,589	▼	\$15.62	▲
Overall Total 3Q20	233,712,798	▲	17,818,494	▼	7.6%	▼	(344,222)	▲	964,082	▼	\$15.51	▲
Overall Total 2Q20	233,309,995	▲	17,081,627	▼	7.3%	▼	(350,453)	▼	1,180,577	▼	\$15.45	▲

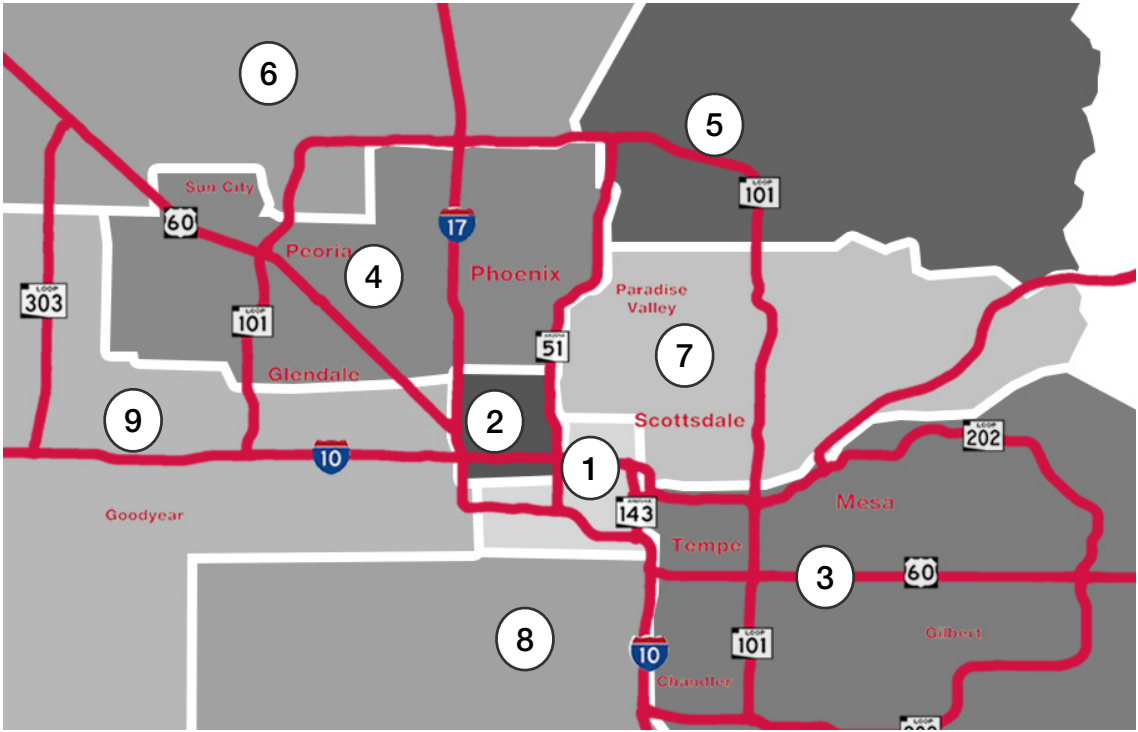
Rental Rates



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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