Limited Construction Buoys Property Performance; Rents Continue Steady Gains

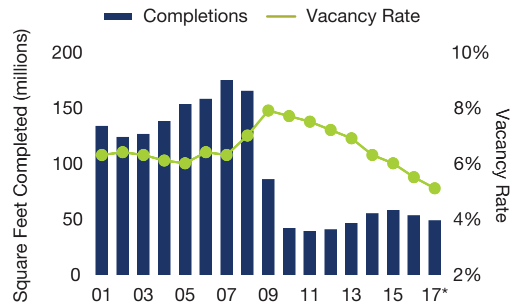
Trends point to continued momentum for retail sector. The combination of numerous positive economic drivers worked together to encourage retailer expansions last year, trends that will continue in 2017. Completions remained constrained, diverting expanding tenants into existing spaces and supporting a drop in the vacancy rate for the seventh consecutive year. These trends have been reinforced by elevated consumer confidence that lifted holiday sales last year above their long-term trend. The consumer expectations index, which gauges consumers' outlook for the next six months, recently reached a 13-year high, a positive for sustaining retailers' outlooks this year. Consumer confidence in the coming year will be supported by solid employment gains, upward pressure on wages and a steady pace of economic growth.

Delivery decline tightens retail property vacancy. With consumer activity rising, retail sales should grow 4 percent this year, a level in line with the long-term average. Though e-commerce and increasingly mobile commerce are capturing a larger share of total retail sales, the ongoing evolution of retail centers as well as new strategies to synchronize physical and online operations have refreshed tenant demand. Despite the many favorable trends, tighter construction lending and investor caution have restrained development, with total 2017 additions equal to less than one-third of the annual totals in the five years preceding the recession. The significant restraint is uncommon at this stage of the growth cycle and will favor retail property performance, pushing the national vacancy rate to its lowest level in more than 16 years. Rent growth will mark its fifth year of gains, rising by 2.4 percent and bringing the average asking rent back within range of the peak set in 2008.

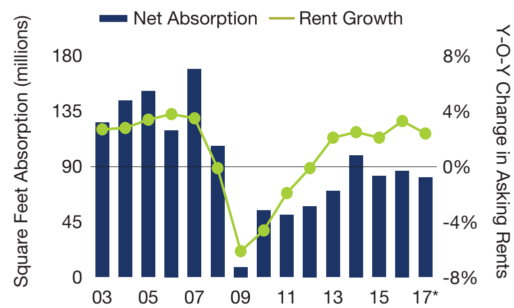
2017 National Retail Outlook

- **Retailer expansions exert downward pressure on vacancy.** Although closures of department stores such as Macy's, Kmart and Sears have generated headlines and concern, they are concentrated in malls and do not affect open-air retail centers. Conversely, specialty retailers Dollar General, T-Mobile and ULTA lead the list of store openings, highlighting the evolving retail climate. In 2016, the national vacancy rate fell 50 basis points to 5.5 percent, and the trend should continue this year, reducing vacancy to 5.1 percent.
- **Development restrained; annual completions to decline in 2017.** This year, 49 million square feet of space will come online, marking a drop from the level recorded in 2016. Single-tenant retail concepts dominate the new stock, and shopping center owners also continue to enhance the value of underutilized or vacant spaces by adding restaurants and service providers, including health clubs.
- **Small-business confidence reawakens, providing a potential source of new retailers.** Small-business optimism dipped to its trough in 2009 and made a rocky recovery as significant improvements in employment and consumption progressed. In December of 2016, the index posted its highest reading since 2004 and maintained that standing in January of this year. Increased confidence on the part of small businesses could support the creation of new retailers, a positive trend that should generate greater in-line space demand in strip centers. A rise in space demand also comes at an opportune time, supporting the growing trend of subdividing former anchor spaces.

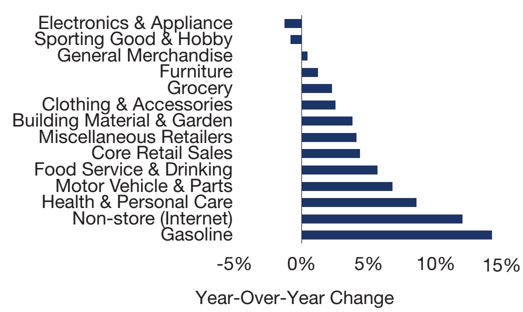
Retail Construction and Vacancy



Net Absorption vs. Asking Rents



Retail Sales Growth **



Small-Business Optimism Trends Near 2004 Peak

* Forecast
** Through January