CBRE

MARKETVIEW

Tucson Retail, Q3 2017

Despite soft quarter, retailers remain active in Tucson

Vacancy	Rental Rate	Net Absorption	Under Construction
7.2%	$15.90 Per Sq. Ft.	(50,272) Sq. Ft.	76,500 Sq. Ft.

*Trend arrows indicate year-over-year change.

Figure 1: Important Retail Indicators

	Tucson Unemployment	*Tucson Employment Growth*	*U.S. Employment Growth*	*Tucson Retail Sales Growth*	*U.S. Consumer Sentiment*
Q3 2016	5.0%	1.7%	1.8%	0.9%	90.8%
Q3 2017	4.5%	0.4%	1.4%	1.7%	95.1%

Source: CBRE Research, Q3 2017. All employment figures reflect the most recent BLS Economy at a Glace data, August 2017. University of Michigan Sentiment. Retail sales from Moody's Analytics, Q3 2017.

Tucson's retail vacancy increased this quarter amid lackluster employment growth and several retailer move-outs. Employment growth in August was underwhelming, expanding 0.4% annually compared to the national rate of 1.4%. However, employment growth in the summer months, especially in Tucson (which has a large student community) expectedly slows. Sluggish job growth and the impact of rising competition between brick and mortar and e-commerce retailers underpinned the 50,272 sq. ft. of negative net absorption this quarter.

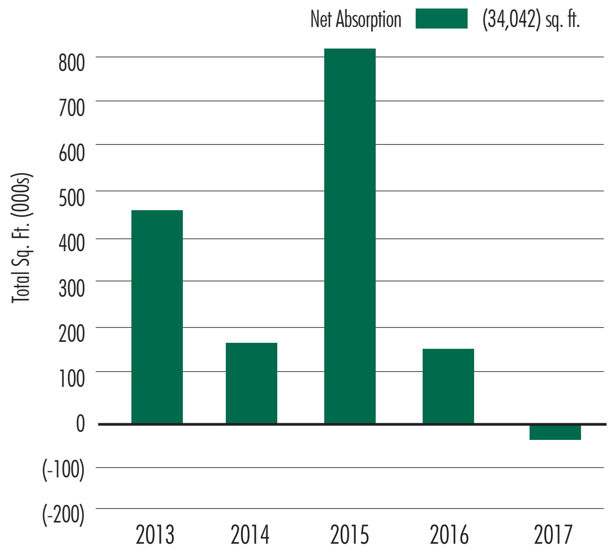
Despite several retailer moveouts marketwide, a number of retailers continued to expand in Tucson. Discount, fitness, fast-casual food and specialty retailers were active throughout the market. These segments and retailers who continue to adapt to changing consumer preferences will continue to grow and support retail space demand. However, retailers expanding in Tucson (including Petco, Ross, HomeGoods and TJ Maxx) have preference for quality, well-located space in trade areas where they have no store presence. As a result, retailers are moving into new build-to-suit (BTS) space where quality existing inventory is not available.

Meanwhile, Tucson's existing retail inventory consists of a significant amount of functionally obsolete retail inventory that disproportionately weighs on the market's vacancy. However, medical and specialty-service users, in particular, are beginning to repurpose these spaces in Tucson. This includes, Iora Health, which absorbed retail space along Grant Road and repurposed it into an urgent care and clinic facility. As additional outdated vacant retail space finds new uses, fundamentals will continue to improve.

NET ABSORPTION

The Tucson retail market ended the third quarter with 50,272 sq. ft. of negative net absorption. The negative net absorption was due to several moveouts marketwide in addition to expanding retailers moving into build-to-suit space. Year-to-date, the market recorded 34,042 sq. ft. of negative net absorption. Still, half of the submarkets (Northeast, Southeast and Northwest) in Tucson recorded positive net absorption in the third quarter. These areas are also where home building is the most prominent. The Northeast submarket led leasing activity this quarter, posting 18,523 sq. ft. of positive net absorption. Meanwhile, negative net absorption totaled 22,254 sq. ft. in the West submarket.

Figure 2:Annual Net Absorption Rate

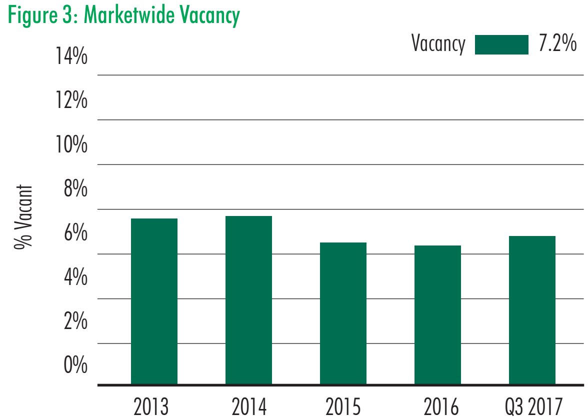


Source: CBRE Research, Q3 2017.

VACANCY

In the third quarter of 2017, negative net absorption pushed up vacancy for the fifth consecutive quarter. Marketwide, vacancy edged up 40 basis points (bps) quarter-over-quarter to 7.2%, marking a 140-bps annual increase. Year-over-year, vacancy increased in half of the submarkets in Tucson. Over the same period, vacancy in the Southwest and West submarkets climbed 310 bps and 260 bps to 7.3% and 3.8%, respectively. Meanwhile, the Northeast and Southeast submarkets recorded a 360-bps and 130-bps decrease in vacancy, both falling to 7.2%, respectively.

Figure 3: Marketwide Vacancy

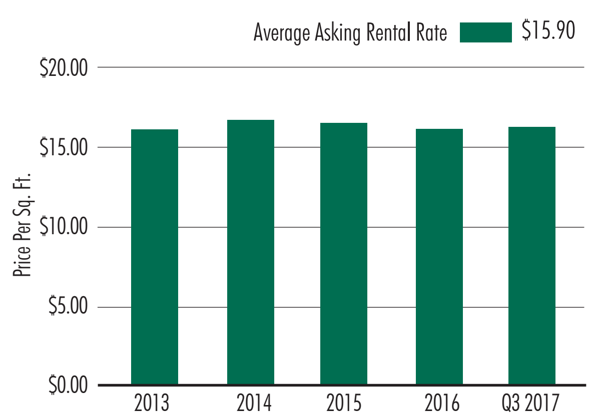


Source: CBRE Research, Q3 2017.

ASKING RENTAL RATE

Despite an increase in vacancy, the Tucson market's average asking rent edged up 2.1% quarter-over-quarter to $15.90 NNN per sq. ft. in the third quarter of 2017. Of the six submarkets, four posted an increase in rent. The Northeast submarket recorded the most significant rent increase, finishing the quarter at $17.29 NNN per sq. ft.—one of the highest rental rates in the market. This climb, which disproportionately lifted the marketwide average, reflects the several new build-to-suit stores and in-line shop space in Houghton Town Center.

Figure 4: Asking Rental Rate ($PSF/MO/NNN)



Source: CBRE Research, Q3 2017.

CONSTRUCTION

Two new spaces came online during the third quarter of 2017, totaling 34,500 sq. ft. Year-to-date, completions in the market total 203,273 sq. ft., outpacing the amount of retail space that was delivered in 2016. Still, developers remain cautious, and new construction is limited to build-to-suit (BTS) space. Both BTS third-quarter deliveries were located in the Southeast submarket in the Houghton Town Center. Petco took 12,500 sq. ft. of space while TJ Maxx moved into its 22,000-sq. ft. store.

Altogether, 76,500 sq. ft. of retail space is currently under construction. This includes the 21,500-sq. ft. Ross Dress for Less in Houghton Town Center, which is expected to be completed next year. Additionally, 55,000-sq. ft. of retail space at the Landing is scheduled to come online in early 2018. Upon full buildout in 2020, the Landing is expected to include 600,000-sq. ft. of retail space.

OUTLOOK

Tucson's employment growth will gain slight momentum and is anticipated to rise 0.9% by year-end 2017.[1] Furthermore, recent job announcements (including Caterpillar, Hexagon Mining, Vector Space Systems, and Bayview Asset Management) are expected to generate hundreds of jobs that will help drive demand for retail.

Despite several move-outs this year, retailers that are either resilient to competition from online sales (grocery and services-based retailers) or those who are adapting to consumer preferences will continue to expand in Tucson. Entertainment, health and fitness, fast-casual and fast-food retailers will remain active. These retailers will continue to seek quality space in high-demand submarkets where residential growth is prominent such as the Northwest and Southeast submarkets.

Additionally, while new supply is significant, it will remain at sustainable levels as construction is limited to BTS projects. Retailer expansions and the reuse of vacant retail space for alternative uses should help support Tucson's retail outlook in the near-term.

[1] Source: University of Arizona, Economic and Business Research Center, 2017.

Figure 5: Retail Market Statistics

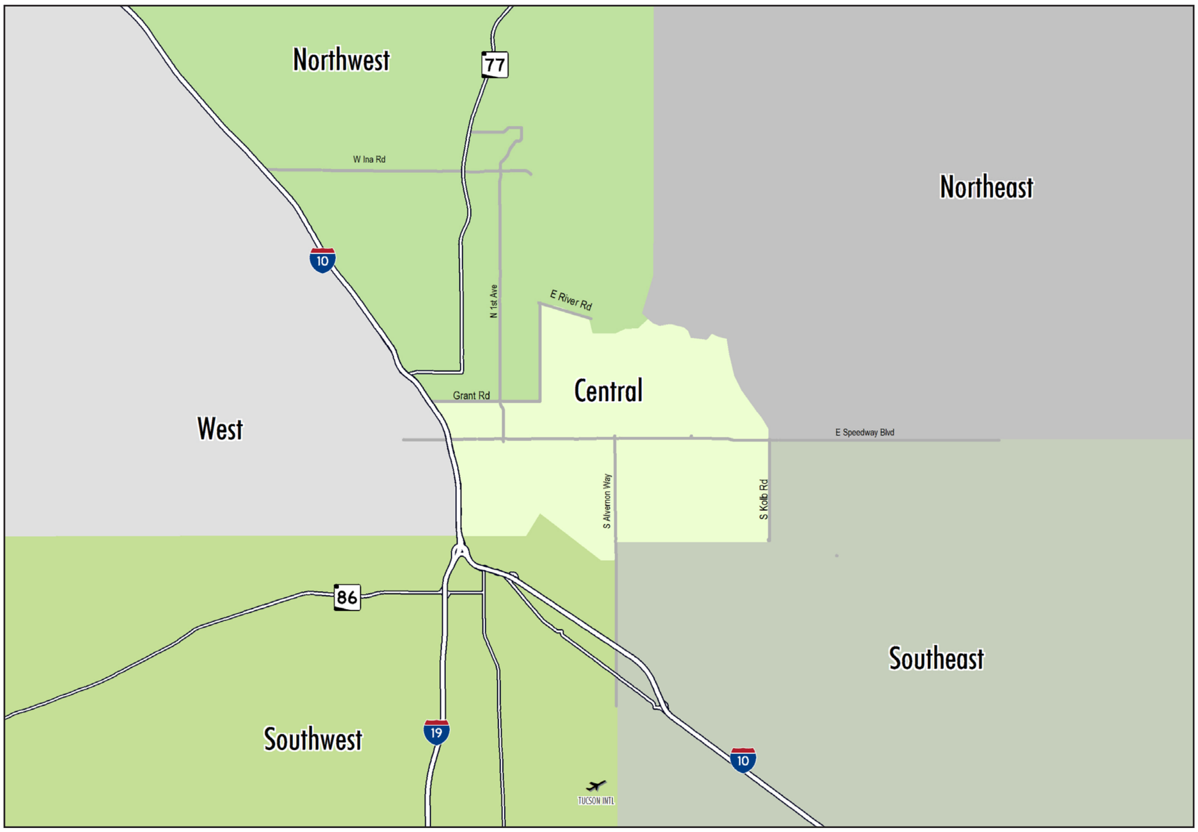
Submarket	Gross Rentable Area Sq. Ft. (±)	Vacancy Rate %	Availability Rate %	Q3 2017 Net Absorption Sq. Ft. (±)	Under Construction Sq. Ft. (±)	*Average Asking Lease Rate (NNN) $
Central	4,824,720	9.7	9.9	(32,481)	0	15.33
Northeast	1,239,218	7.2	7.2	18,523	0	17.29
Northwest	9,285,991	6.1	6.3	499	0	16.56
Southeast	2,844,054	7.2	7.6	7,591	21,500	15.65
Southwest	4,036,061	7.3	7.5	(22,150)	55,000	15.15
West	859,377	3.8	3.8	(22,254)	0	17.72
Totals	**23,089,421**	**7.2**	**7.4**	**(50,272)**	**76,500**	**15.90**

*Lease rates are quoted as weighted average of all NNN lease asking prices per sq. ft. per year.
Source: CBRE Research, Q3 2017.

Figure 6: Key Transactions

Size Sq. Ft. (±)	Tenant	Address
17,929	Skechers	7200 E Broadway Blvd.
7,334	Burlington Mattress	4741-4751 E Speedway Blvd.
5,835	Discount Warehouse	4501-4525 E 22nd St.
4,881	Phoenix Salon Suites	5420 E Broadway Blvd.
4,800	Wings Over Broadway	8816 E Broadway Blvd.

Source: CBRE Research, Q3 2017.



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