CBRE

MARKETVIEW

Tucson Retail, Q4 2017

Retailers shift to suburbs; vacancy edges up

Vacancy	Rental Rate	Net Absorption	Under Construction
7.2%	$15.70 Per Sq. Ft.	4,382 Sq. Ft.	55,000 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*
Q4 2016	4.4%	2.3%	-1.5%	-0.8%	98.5%
Q4 2017	4.0%	-0.7%	0.9%	-1.2%	94.4%

Source: CBRE Research, Q4 2017. All employment figures reflect the most recent BLS data, November 2017. University of Michigan Sentiment. Retail sales from Moody's Analytics, Q4 2017.

Tucson's retail market ended the fourth quarter of 2017 with a mixed outlook. Employment growth was slower than anticipated, declining 0.7% over the past 12 months. However, Tucson's suburban submarkets continued to grow as retailers opened build-to-suit (BTS) space in new developments, leaving behind older space in Tucson's core. Additionally, big box users continue to increase their footprint. Hobby Lobby, for example, recently announced plans to expand and renovate existing space in the Northwest submarket to meet requirements for a new location.

Retailers continued to vacate space in central Tucson for areas where new development or BTS opportunities were available. Tucson's Central submarket is one of the largest retail submarkets, consisting of 4,824,720 sq. ft. of rentable space. However, demand for newly constructed space in outlying submarkets has caused the Central submarket's vacancy rate to reach double digits, leaving a significant amount of outdated space vacant. The Southeast and Southwest submarkets, however, recorded the most improvement during the fourth quarter, each logging over 24,000 sq. ft. of net absorption. This was largely due to retailers such as Ross Dress for Less moving into BTS space outside of central Tucson to these outlying areas where homebuilding is prominent.

Net absorption slightly improved during the quarter with 4,382 sq. ft. of positive net absorption. Because a significant amount of activity consisted of existing tenants shifting space throughout the market, vacancy remained fairly stable, edging down 10 basis points quarter-over-quarter to 7.2%. Discount retailers, health and fitness among other specialty-service providers remained active throughout Tucson in Q4 2017.

NET ABSORPTION

Tucson's retail market ended the fourth quarter with 4,382 sq. ft. of net absorption. Over the full year, the market recorded 29,660 sq. ft. of negative net absorption. Large move-outs in the Central and Northwest submarkets attributed to the negative absorption rate in 2017. The Northwest submarket recorded 40,225 sq. ft. of negative net absorption, Tucson's lowest absorption rate during Q4. Over the same period, both the Central submarket and Northeast submarket posted 28,485 sq. ft. and 5,866 sq. ft. of negative net absorption, respectively. Much of this negative absorption was due to tenants shifting to the Southeast and Southwest submarket seeking new development space. As a result, the Southwest and Southeast submarkets recorded 52,490 sq. ft. and 24,096 sq. ft. of net absorption, respectively. Developments such as The Landing in the Southwest submarket continues to attract retailers looking for updated space and growing populations.

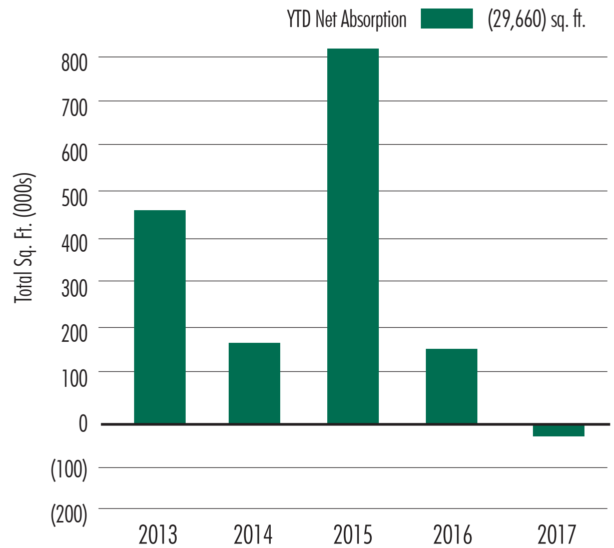
VACANCY

Marketwide vacancy decreased slightly in the fourth quarter of 2017, ending the year at a 7.2%. On a quarter-over-quarter basis, vacancy ticked down 10 basis points (bps), yet increased 10 bps annually. Negative net absorption pushed up vacancy in the Central, Northeast and Northwest submarkets, each increasing 40 bps or more quarter-over-quarter. Meanwhile, the Southwest submarket recorded a quarter-over-quarter decrease of 130 bps to a 6.0% vacancy rate. Additionally, vacancy in the Southeast and West submarkets fell 90 bps and 30 bps, respectively. Tucson's largest retail submarket, the Central submarket, ended Q4 2017 at 10.3% vacancy, the highest vacancy rate in this area since Q1 2014.

ASKING RENTAL RATE

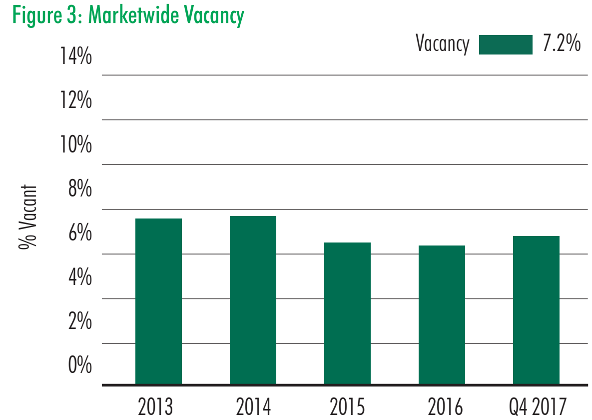
Tucson's average asking lease rate fell 1.3% to $15.70 NNN per sq. ft. in Q4 2017. The Northeast submarket posted the greatest increase in average asking rents on a quarterly basis as rent increased 4.7% to $18.10 NNN per sq. ft.—the highest rental rate marketwide. Over the same period, the Central submarket recorded the greatest decline in asking rent, reducing 4.8% to $14.59 NNN per sq. ft. As new retail space and BTS opportunities continue in Tucson's periphery, outdated space in Tucson's core will weigh on vacancy, causing average asking rents to decrease.

Figure 2:Annual Net Absorption Rate



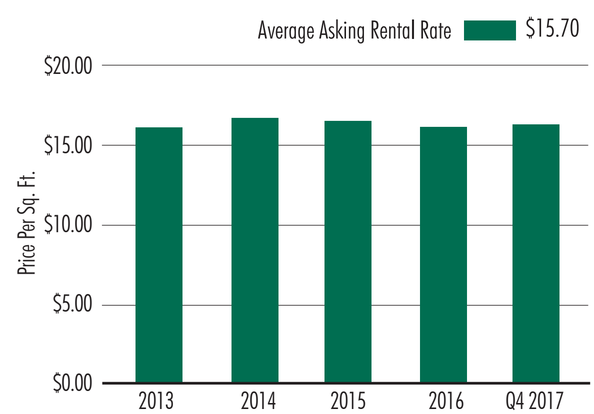
Source: CBRE Research, Q4 2017.

Figure 3: Marketwide Vacancy



Source: CBRE Research, Q4 2017.

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



Source: CBRE Research, Q4 2017.

CONSTRUCTION

The only space delivered this quarter was the 21,500-sq.-ft. BTS for Ross Dress for Less at Houghton Town Center in the Southeast submarket. Marketwide, Tucson logged 224,773 sq. ft. of new construction in 2017, which bodes well for outlying submarkets to the Southeast and Southwest, where a majority of construction activity occurred in 2017. More than 55,000 sq. ft. of speculative projects are currently underway at The Landing in the Southeast submarket. Tenants who are currently lined up for this space include Taco Bell and Chipotle which will join the 600,000-sq.-ft., master-planned development in the first half of 2018.

In addition, over 350,000 sq. ft. of retail space is in the planning pipeline for the Southwest submarket as developments such as The Bridges continue to gain traction. Meanwhile, the Northwest submarket has 547,328 sq. ft. in the planning pipeline. However, 50,000 sq. ft. of this space includes a remodel of vacant space in Plaza del Oro for a new Hobby Lobby, which is slated for completion in early 2018.

OUTLOOK

Despite lackluster employment growth in 2017, Tucson's market is expected to steadily improve in 2018. Employment is expected to grow 1.2% next year, with service-providing employment forecasted to expand 1%.[1] Additionally, major job expansions—including Geico's recently announced Tucson corporate center that will house 700 additional employees—are expected to continue unfolding in 2018, which will spur demand for retail.

Despite a relatively optimistic demand outlook, large move-outs will continue to impact vacancy in Central Tucson, as retailers relocate or build new space in the suburban market. The vacant space left behind by these retailers will likely undergo major renovation or redevelopment as tenants adapt to the changing retail landscape. Users in discounted goods, entertainment and health and wellness will continue be the most active.

While new construction will remain limited to BTS projects in the Southeast and Southwest submarkets, pressure to redevelop or repurpose outdated space in central Tucson will increase. This, in addition to the limited number of tenants entering the market, will place upward pressure on average asking lease rates marketwide. In addition, adaptive reuse projects to convert retail into general office, medical use and the like will ensue into 2018.

[1] Source: Bureau of Labor Statistics, November 2017.

Figure 5: Retail Market Statistics

Submarket	Gross Rentable Area Sq. Ft. (±)	Vacancy Rate %	Availability Rate %	Q4 2017 Net Absorption Sq. Ft. (±)	Under Construction Sq. Ft. (±)	*Average Asking Lease Rate (NNN) $
Central	4,824,720	10.3	10.5	(28,485)	0	14.59
Northeast	1,239,218	7.7	7.7	(5,866)	0	18.10
Northwest	9,285,991	6.5	6.8	(40,225)	0	16.47
Southeast	2,844,054	6.3	6.8	24,096	0	15.47
Southwest	4,036,061	6.0	6.2	52,490	55,000	15.38
West	859,377	3.5	3.5	2,372	0	17.34
Totals	**23,089,421**	**7.2**	**7.4**	**4,382**	**55,000**	**15.70**

*Lease rates are quoted as weighted average of all NNN lease asking prices per sq. ft. per year.
Source: CBRE Research, Q4 2017.

Figure 6: Key Transactions

Size Sq. Ft. (±)	Tenant	Address
12,100	Latitudes Furniture	4721 E Broadway Blvd.
15,377	Boot Barn*	3702-3744 S 16th Ave.
6,868	Tamarind Properties	7265 N La Cholla Blvd.
6,000	American Charter Schools Foundation	1758 E Irvington Rd.
4,637	Grasky Endurance Coaching	4755 E Grant Rd.

Renewal*
Source: CBRE Research, Q4 2017.

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