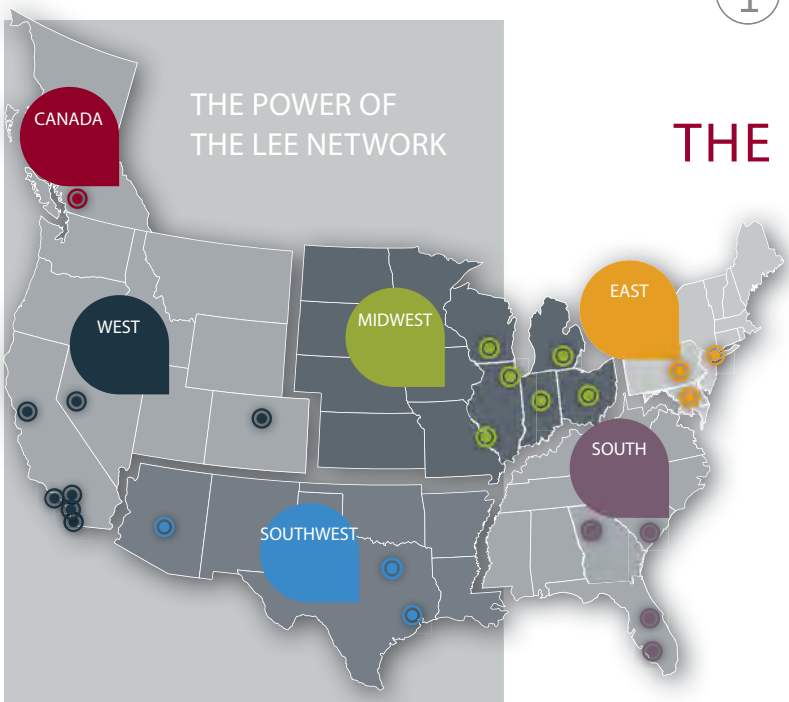
The Lee Retail Brief

Q3

2017

LEE & ASSOCIATES®

COMMERCIAL REAL ESTATE SERVICES



THE LEE ADVANTAGE

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1. **MARKET LEADER** — SPECIALIZING IN MARKET INTELLIGENCE
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AFFILIATE INTERNATIONAL RELATIONSHIP

GERALDEVE

- AUSTRIA
- BELGIUM
- FRANCE
- IRELAND
- LUXEMBOURG
- NETHERLANDS
- POLAND
- SLOVAKIA
- SPAIN
- TURKEY

62% increase in transaction volume over 5 years

$11.6 billion transaction volume 2016

900 agents and growing nationwide

US RETAIL MARKET

Absorption Softens - Vacancy Unchanged

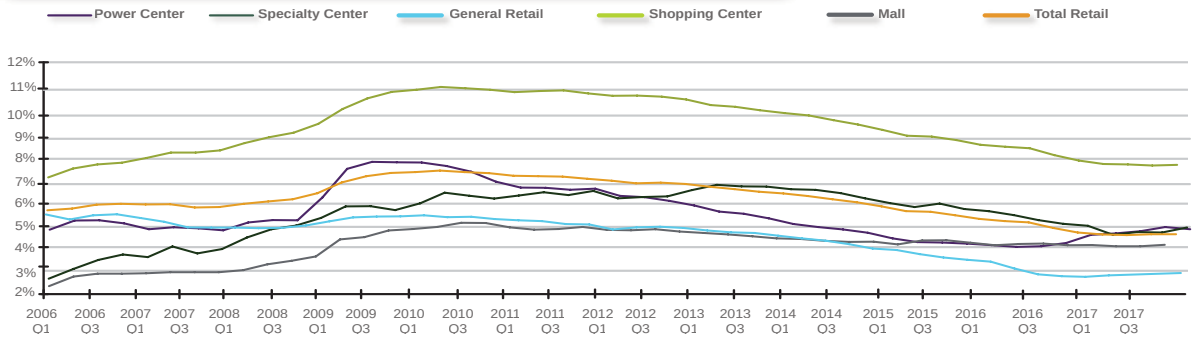
TRENDING IN Q3

- Net absorption declines for sixth straight quarter
- Vacancy unchanged for fourth straight period
- Overall rent growth at 3.7% in past year
- Undersupply of space in prime urban submarkets
- Online sales growth perpetuates brick-and-mortar woes

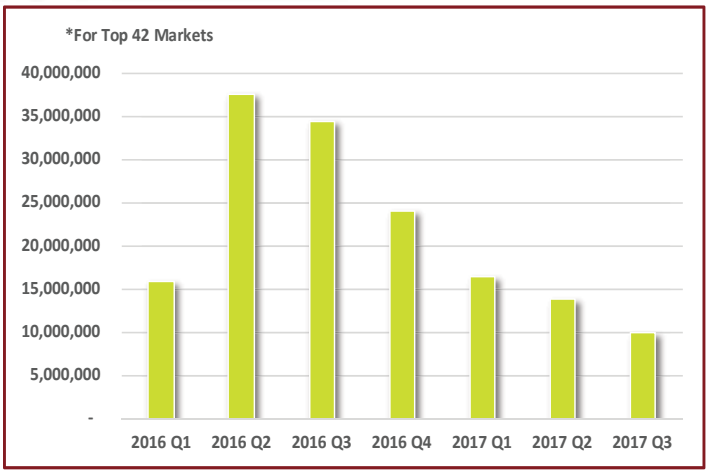
ECONOMIC DRIVERS
GROWTH
EMPLOYMENT
MONETARY POLICY
GLOBAL ECONOMY

A LOOK AHEAD

VACANCY RATES BY BUILDING TYPE 2006-2017



NET ABSORPTION



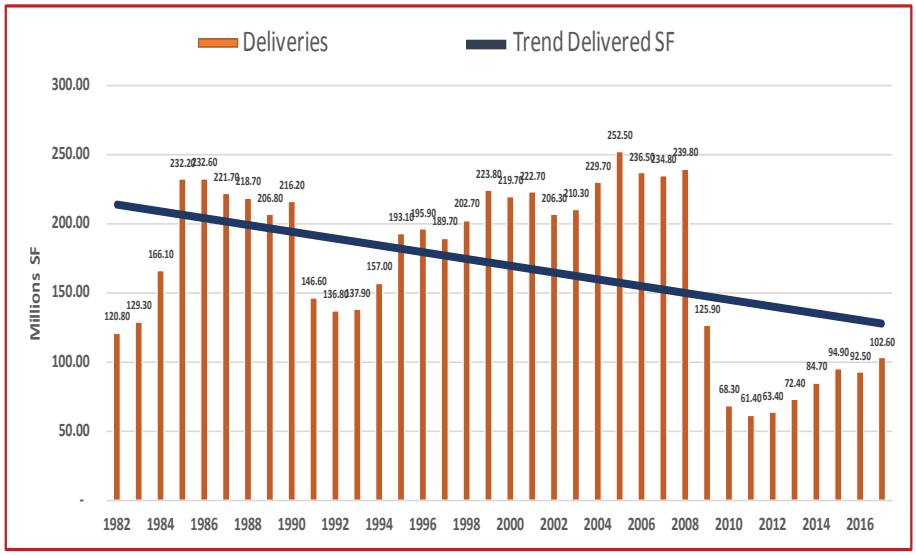
Despite overall market metrics that point to a relatively healthy retail sector, massive changes in the way retailing is done in today's tech-driven economy poses ongoing challenges to a broad array of retailers, many of whom are reinventing themselves to remain relevant. Traditional department store operators like Macy's, Sears and JC Penny are, perhaps, the best example of this persistent trend. They, along with others like them, have been closing stores, streamlining cost structures and shifting focus to their own online sales platforms to compete with the likes of Amazon, the undisputed game changer in retail.

Walmart has doubled-down on its efforts to beat Mr. Bezos at his own game. Already the world's largest brick-and-mortar retail, the Arkansas-based company, paid over $3 Billion to acquire Jet.com to give it an online boost as it pours additional capital into expanding its supply chain to handle greater online sales volume. Clearly, Walmart has no intention of depending on its historical model in the face of Amazon's growth strategy and amazing results. Recent financial results indicate that Walmart is making progress, as the company is reporting improved earnings growth, much of that due to a boost in online sales. Walmart is not just competing with Amazon on price. It is adding products, promoting shipping discounts and reducing delivery times, as well. The latter requires an improved last mile delivery network, which it is investing heavily in with new fulfillment centers around the country and increased automation in its warehouses.

Yet, Amazon keeps raising the bar. The company recently leased a fleet of cargo planes to deliver its own orders, then bought the leasing company and invested further in a regional airport near Cincinnati to base their air operations. Amazon's strategy to plow almost all of its profits into further expansion efforts makes it particularly difficult to compete with. In its most recent earnings report, the company reported just $252 million in profit on revenues of almost $44 billion. Yet, the stock reached another new high and Mr. Bezos secured his status as the world's richest man, surpassing Bill Gates of Microsoft fame.

For the past year, the vacancy rate has remained unchanged at 4.7%, despite improving macroeconomic conditions including stronger GDP growth, lower unemployment, low inflation and moderate, but still disappointing wage growth. But, reported vacancy in secondary submarkets ranges much higher. General Retail (freestanding, general purpose properties) still boasts the lowest vacancy of all retail property types, holding steady at 2.9% at the end of Q3 on a base of 6.86 billion square feet. Mall vacancy fell 10 basis points in the quarter to 4.4%, while Power Center vacancy was unchanged at 5.0%. Shopping Center (neighborhood, community and strip centers combined) rates are still highest at 7.7%, unchanged for the quarter, but this category contains suburban, unanchored centers that are having the most trouble staying leased.

HISTORICAL DELIVERIES 1982 - 2017



Net absorption, while still positive nationwide, has been trending lower since Q2 of 2016. Net absorption in the third quarter fell to 12.1 million square feet nationwide, a 4-million-square-foot decline compared to last quarter and an 18-million-square foot decline compared to Q4 of last year. For the top 43 markets tracked by CoStar, net absorption for the first three quarters of 2017 stood at 40 million square feet compared to almost 88 million square feet for the same period last year.

As we have noted in the past, the macro absorption doesn't point only to lower demand. In prime locations that allow retailers to target their preferred customer demographics, it's the lack of available space rather than a lack of demand that is cutting into net occupancy growth. That said, the overall numbers leave little doubt that online retail sales growth poses a massive ongoing challenge to a broad variety of brick-and-mortar retailers. Even the grocery business is facing an online challenge, as Amazon's acquisition of Whole Foods earlier this year makes clear.

Urban areas with adequate available space continue to see better occupancy growth, as retailers focus more on younger customers. Multifamily housing near public transportation hubs have gained in popularity with millennials who are more inclined to forego home and automobile ownership for the convenience and flexibility of rental housing along with walkable amenities like hip restaurants, cool bars and entertainment venues. On the other hand, owners of shopping centers and malls in outlying suburban areas are having a tougher time attracting tenants. Strip centers are seeing more interest from mom and pop operators, which creates higher turnover, and mall owners are fighting to keep traditional anchor retailers like department stores from closing their doors.

Despite struggles in the retail industry, rents keep moving higher with remarkable consistency. The overall rate was up again in Q3, adding another $.13 to end the period at $16.21 per square foot. Over the past four quarters, retail rents across all product types and locations moved up by just over 3.7%, but the strongest rent growth remains in urban locales rich in amenities. Going forward, it will be retail properties where the Baby Boomers are that will have an even bigger battle to maintain occupancy and grow rents. This major demographic group is turning 65 at a rate of approximately 10,000 per day and is likely to spend less on retail purchases as they get older.

New deliveries slipped by almost 5 million square feet quarter-to-quarter with 17.3 million square feet added to inventory in Q3. The US now boasts a retail base inventory of almost 13.3 billion square feet. In the past four quarters, 86.8 million square feet of new space has been delivered, while another 85.5 million square feet remains under construction. Of the top 15 retail projects delivered in 2016, only one was completed without preleasing commitments. The balance were either fully or substantially preleased. Of the top 15 projects currently in the construction queue, five are 0% preleased and another five are 100% leased.

A LOOK AHEAD

The US retail market growth will remain concentrated in urban core areas, rich in walkable amenities. A resurgence in hiring could boost retail sales, but wage growth will remain tepid, much to the consternation of our central bankers at the Fed. No significant legislation is likely to get to the President's desk any time soon. The tax reform proposal currently being debated has many controversial components that are bound to get resistance from a handful of Republican Senators, which is all that is needed to stop the process. If passed, the tax reform proposal could have an impact on retail spending, but it's too soon to say who the winners and losers will be. Discussion on an infrastructure spending bill is conspicuously absent, so any potential consumer spending increases that would result from new projects are potentially years away.

Expect online sales growth to continue and with that more big changes for retailers that sell products that can be bought with a smartphone. Landlords will be looking to "internet proof" their properties by pursuing retailers that provide personal services or entertainment experiences customers can't buy online. The health and fitness industry along the dollar store sector will continue to provide support for retail centers that have lost big anchors.

Efforts by national chains to reduce store footprints and increase their online sales platforms will be ongoing. Amazon continues its rapid expansion and it is particularly intent on growing its third party seller platform, which accounted for over 70% of Amazon's gross revenues so far this year. The platform gives retailers of all sizes and product lines the full advantage of the world's largest and most efficient online platform.

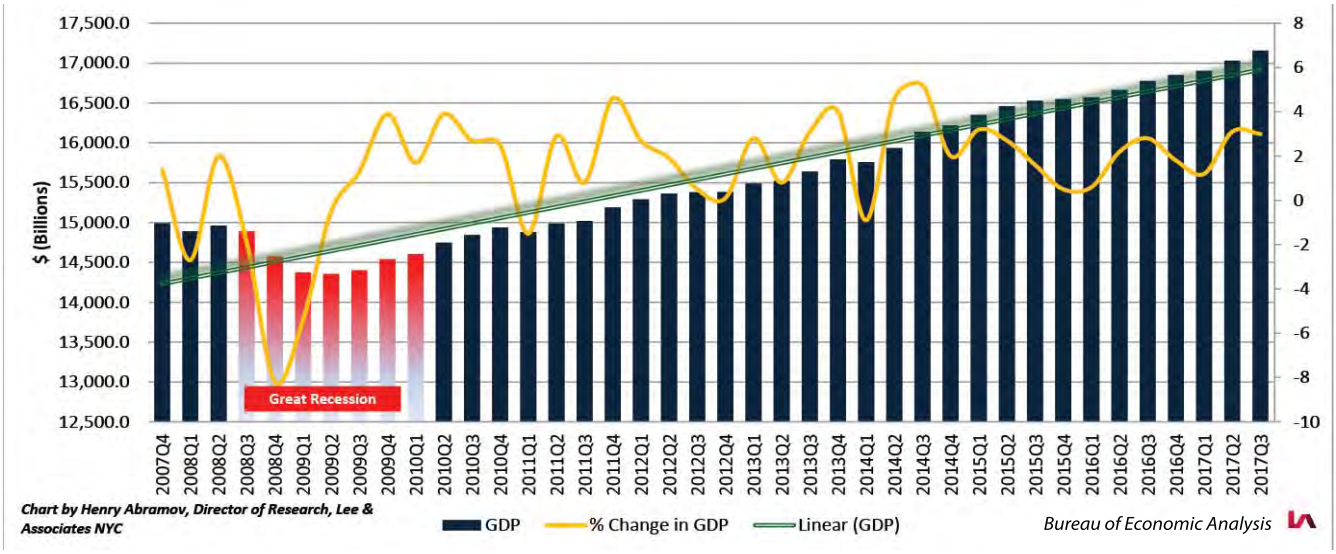
Given all the challenges the retail industry faces today, US retail property market metrics still support a relatively stable retail property market going forward. Vacancy is low, markets are not overbuilt, rent growth is ongoing and net absorption is still in positive territory. Expect more of what you already see in the next few quarters.

GDP GROWTH

TRENDING IN Q3

- Q3 GDP comes in above expectations at 3.1%
- Impact of multiple hurricanes less than forecast
- Consumer spending softens but stays in positive territory
- Businesses bulk on inventories
- Softer US Dollar boosts imports
- Inflation moves higher but stays well below Fed target

QUARTER-TO-QUARTER GROWTH IN REAL GDP



The first estimate of GDP growth for the third quarter came in above expectations at 3.0%. For the first time since 2014, the US economy posted back-to-back growth number of 3% or more. After disappointing performances in Q4 of 2016 and Q1 of 2017, the economy seems to have gained momentum, posting strong gains in consumer spending, business investment and exports, three of the four major components of the GDP formula. The fourth, government spending, fell by .1% in Q3, much to the delight of those looking to depend less on government as a key economic driver.

In Q3, consumer spending, which accounts for roughly 70% of GDP, grew at an annualized rate of 2.4%, despite a spending decline in hurricane-ravaged areas of Texas and Florida. Those decreases are likely to reverse in Q4, as those hit by the storms spend on recovery efforts and return to normal spending patterns.

Net investment by the nation's businesses was a major contributor to the strong economic performance in the third period. Nonresidential fixed investment grew at an annualized rate of 3.9%, which may be a precursor to an increase in productivity in the near term. That could bolster job growth and put upward pressure on tepid wage growth, a main concern of our central bankers.

GDP GROWTH

Inventories also rose sharply in Q3, but that may just be a response to the fact that inventories were allowed to deplete earlier in the year.

The softer US Dollar helped boost US exports by 2.3% in Q3, taking a chunk out of the trade deficit, a persistent drag on GDP. Credit is partly due to rising levels of oil and gas exports from Gulf Coast ports, which have risen sharply in recent quarters.

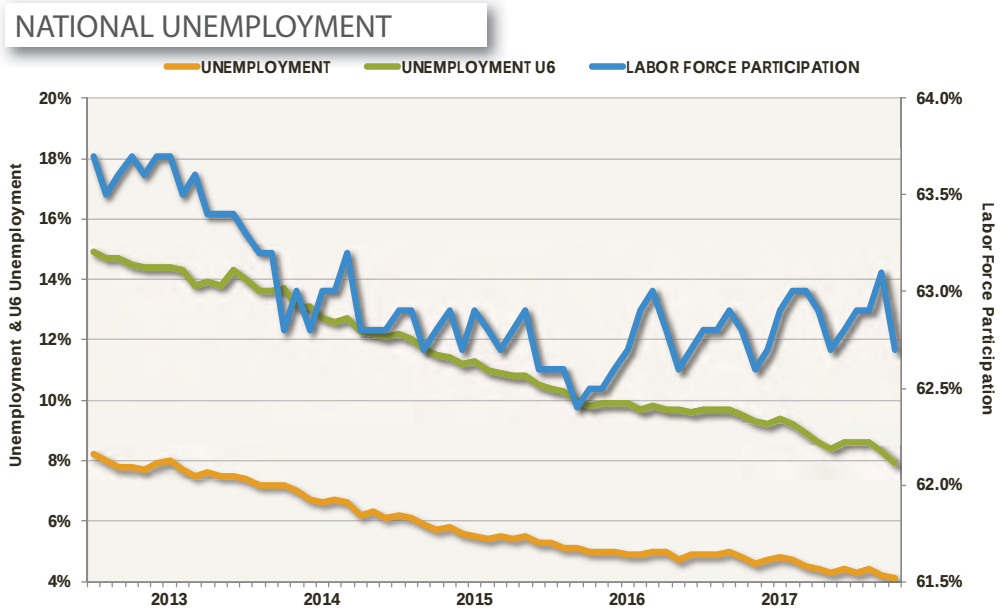
Inflation remains stubbornly below the Fed's target of 2%, but both measures of inflation moved higher in Q3. Core inflation, which strips out food and energy, picked up to a 1.3% annualized rate in Q3, while inflation in personal consumption expenditures, increased to 1.5% on an annualized basis, up sharply from the previous quarter.

EMPLOYMENT

TRENDING IN Q3

- Monthly job gains remain sporadic
- U3 Unemployment rate is down to 4.2%
- U6 Unemployment rate fell to 8.3% in September
- Job growth in manufacturing remains sluggish
- High percentage of new jobs are at the lower end of the wage scale
- Wage growth remains sluggish 9 years into economic recovery

Monthly job creation metrics remain sporadic, but over the past 12 months employers have added an average of 185,000 jobs each month, which many economists believe should be enough to tighten up the labor market and put upward pressure on wages. However, job growth, whether it's measured month by month or a rolling twelve month average, has definitely cooled off. In September, the U3 unemployment rate fell to a post-recession low. U3 measures employed workers and those who are unemployed but have sought employment in the most recent five weeks. So, job growth in a given month can be slow, but the unemployment rate will go down if more people stop looking for work. This happened in September when the U3 rate went down 20 basis points when there was a net loss of 33,000 jobs. Conversely, a big month for job growth is often accompanied by a rise in the U3 rate as those not actively looking for work start looking again and are added back into the calculation.



For this reason, more experts are looking to the U6 unemployment rate, which is a broader index that also includes part time workers, who prefer to work full t ime, as unemployed. That rate has been falling steadily, ending September at 8.3%.

Unfortunately, too many of the jobs created and counted each month are either part time or at the lower end of the wage scale. This explains the feeling of many workers who feel as though the recession never ended. In fact, of the top 30 fastest growing occupations as measured by the Bureau of Labor Statistics, 17 of them had a median annual wage of less than $35,000 and just eight of them had an average annual wage of more than $50,000.

EMPLOYMENT

Only one exceeded $100,000. Compounding this problem is the fact that many jobs that require specific skills and experience go unfilled due to a lack of qualified candidates, and these are often higher-paying, full time positions. Add the fact that high-skilled manufacturing jobs, positions that many are qualified for, have either been exported overseas or lost to advances in automation.

Job growth drives business growth and business growth drives net absorption of office, retail and industrial space. So, uneven job growth and weak wage growth may be at least partly to blame for across-the-board declines in Q3 net absorption.

MONETARY POLICY

TRENDING IN Q3

- Four vacancies on seven-member Board of Governors gives Trump a chance to shake things up
- Powell tapped to replace Janet Yellen as Fed Chairman
- FOMC passes on rate hike in September, but experts predict another bump in December
- The unwinding of the Fed's $4.5 trillion balance sheet begins in Q4
- Yellen hedges on prediction on further rate hikes based on weak inflation data

Concern over unprecedented vacancies on the Fed's Board of Governors is causing increasing investor uncertainty. Currently, four of the seven seats are empty. The latest resignation came from Stanley Fischer, who gave notice in September. Since all seven Governors also sit on the 12-member Federal Open Market Committee (FOMC), the group that weighs in on moving rates is making big decisions on monetary policy shorthanded. By law, the President nominates candidates for the Board, but thus far, none of President Trump's nominees has been confirmed by the Senate.

US TREASURY RATES

Provided by Henry Abramov Lee & Associates - NYC

Department of the Treasury

The President has made his decision not to re-appoint Janet Yellen to a second term as Fed Chairman, instead nominating current Board member Jerome Powell for the position. Four others were in contention, including economist John Taylor, who would have been the only controversial pick, due to his belief that changes in the Fed Funds rate should be made by mathematical formula rather than by vote. In the end, Mr. Powell is a safer pick in terms of continuity in Fed policy, as he has a history of voting in lockstep with Ms. Yellen. Thus, the move for Mr. Powell for the chairmanship probably means it's more of the same in terms of monetary policy. However, his views on regulating banking activity as seen as more business friendly than those of Ms. Yellen. That bodes well for the big banks.

The current Fed Funds rate ranges from 1.00% to 1.25%, but most of the experts think another 25 basis point rise is likely after the FOMC meets in December. Since it is expected already, investors are likely to build it into decision making beforehand.

What is altogether unknown is the impact of a rate hike in conjunction with the unwinding the Fed's massive balance sheet that includes roughly $4.5 trillion in US Treasuries and Residential

MONETARY POLICY

Mortgage-Backed Securities (RMBS) it bought with electronically printed dollars, a process known as Quantitative Easing (QE). Recently, Ms. Yellen announced that beginning in October, $6 billion in Treasuries and $4 billion in RMBS would come off the balance sheet each month, with those amounts to grow substantially over time. Since it's never been done, no one knows what the outcome will be, but if QE actually helped drive down rates and stimulate the economy, it's hard to argue that reversing the process won't have the opposite effect.

On top of all that, inflation remains stubbornly under the Fed's 2% target and Ms. Yellen is already on record as saying that current monetary policy could reverse course if inflation stays too low. Fortunately, inflation picked up in Q3, which will help keep Fed policy on its current trajectory for the time being. Those of us in the real estate business have to keep a close eye on the yield of the 10 Year T-Bill, as that is the mostly widely used benchmark to determine commercial property mortgage rates. So far, that yield is holding in the 2.3% range, which means mortgage rates remain near historic lows for the moment. However, there is a correlation between the Fed Funds Rate and the yield on the 10 Year T-bill. So, if the Fed follows its present course over the next year, mortgage rates will move higher.

GLOBAL ECONOMY

After a pretty rough year in 2016, global economic activity has definitely picked up in 2017. The panic over the Brexit is over and fears of an economic whiplash have faded. The Bank of England, the UK's counterpart to our Fed, even raised interest rates for the first time in recent memory, indicating that central bank's belief in near-term economic growth. So far, it looks like London won't lose its status as a financial hub in that part of the world.

EURO AREA REAL GDP[2]
(QUARTER-ON-QUARTER PERCENTAGE CHANGES)

GDP growth around the world is improving with all continents around the globe reporting stronger growth this year. That's not to say that economic woes don't continue in many areas, but there is less bad economic news on the front pages of major newspapers these days, reducing concerns of another global economic setback anytime soon.

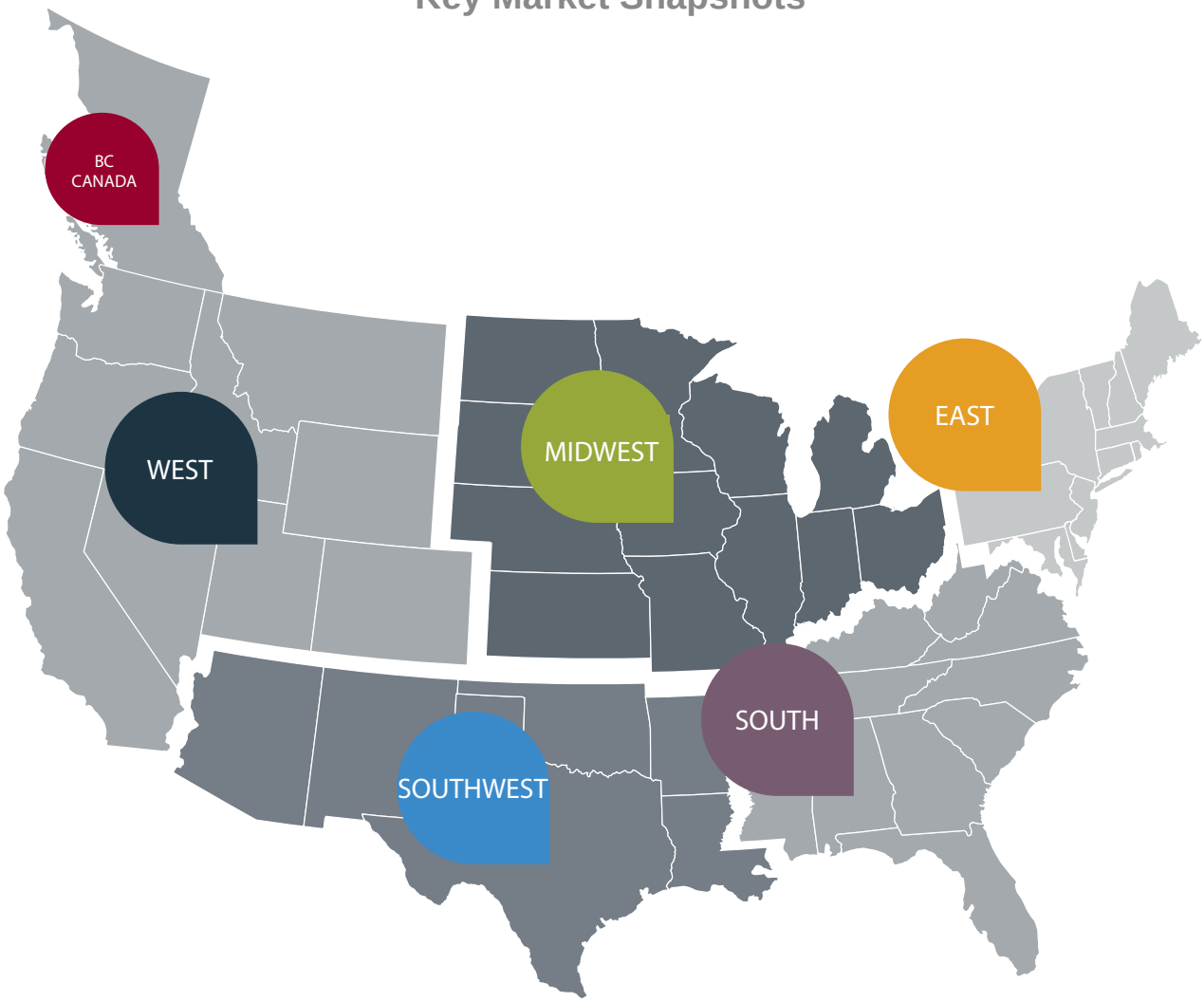
All eyes are on the European Union this year. After several pivotal elections that could have shifted power to more nationalistic parties, results were mixed, leaving things pretty much as status quo on the continent. Recently, the European Central Bank (ECB) announced its plans to scale back its Quantitative Easing (QE) policy by beginning to gradually reduce its bond buying from its current 65 Billion Euro per month level. No word from Chairman Draghi on raising benchmark interest rates, which remain in negative territory, a policy that still spooks economists worldwide. The ECB's monetary policy helped the EU beat the US in terms of GDP growth in 2016, but Mr. Draghi has watched US economic growth improve this year despite a higher Fed Funds rate and a suspension of QE. This could explain the recent hawkish rhetoric coming out of Europe these days.

China's economy and stock markets have also stabilized, which has relieved anxiety over a potential economic crisis in the world's second largest economy. China's leader Xi Jinping has taken a more active role in controlling economic events, consolidating his power in the process. New restrictions on capital flowing out of China have made it clear that he is willing to assert himself and the communist party as it relates to economic policy. China has also taking a more aggressive stance in terms of air pollution by actively promoting the country's active leadership in electric vehicle production.

As we reported last quarter, trade throughout Asia has improved in 2017 despite the fact that the US pulled out of the Trans Pacific Partnership trade agreement after Donald Trump took the reins as President. Tensions between the US and China over what constitutes fair trade between the world's two largest economic engines are heating up, but that hasn't stopped other East Asian nations from boosting trade this year. Port activity is up with most regions signaling robust growth moving forward.

GLOBAL ECONOMY

Tension in the Middle East, on the other hand, is on the rise, as long held differences between major oil powers have again been laid bare. Saudi Arabia blames Iran for troubles in Yemen and Qatar has been ostracized by several Middle Eastern countries for its alleged ties to terrorist activities. Problems persist in Syria and Kurds are still pushing for independence in Iraq. Through all that, the oil keeps flowing and OPEC countries have mainly complied with their recent agreement to curb oil production in an effort to bring supply and demand further into balance.



FEATURED MARKETS THIS QUARTER

WEST
San Diego

EAST
Manhattan

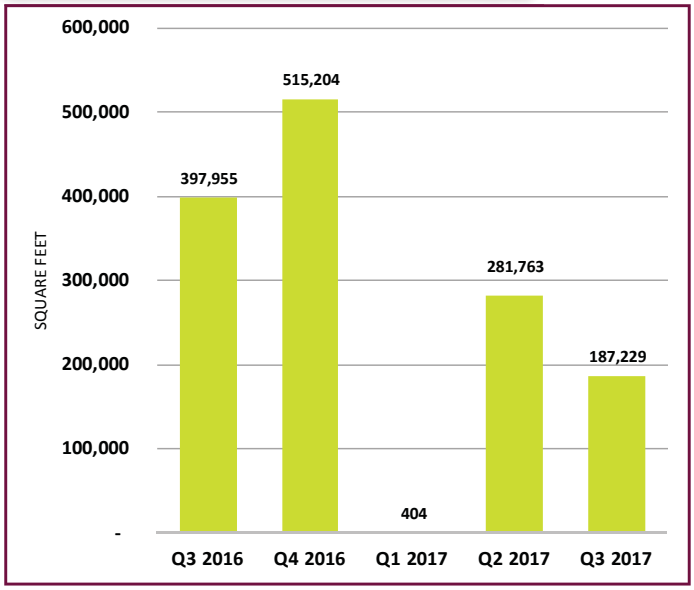
MIDWEST
Indianapolis

SOUTHWEST
Dallas/Fort Worth

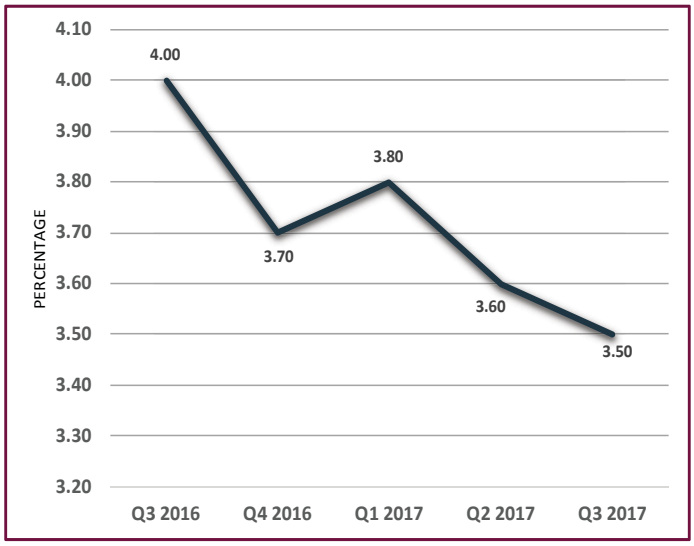
SOUTH
Charleston

WEST REGION - SAN DIEGO

NET SF ABSORPTION



VACANCY RATE



TRENDING IN Q3

- Supply of quality space tightens further
- Vacancy drops to lowest level since 2007
- Fitness Centers and discount retailers among most active
- Year-over-year net absorption declines

Retail market activity in San Diego remained headed in the same direction in Q3, but tightening conditions and a lack of quality supply is causing the market to lose some of its forward momentum. Net absorption declined and new deliveries were light, but vacancy moved slightly lower and rents managed another increase in Q3. Current retail inventory now totals 136.1 million square feet with another 743,094 square feet in the construction queue.

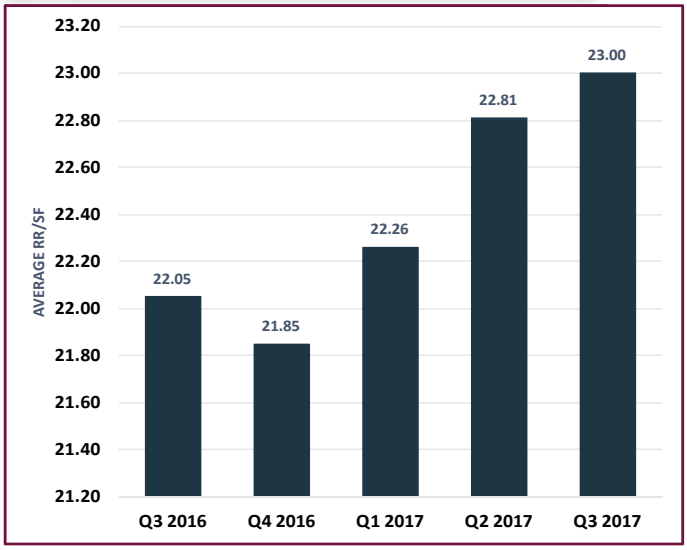
Net absorption has definitely cooled off this year. Through the first three quarters of 2017, just 469,396 square feet of net gain in occupied space has been reported, versus 1,236,539 in the same period last year. That substantial decrease, however, is mainly due to dwindling supply of top quality space in prime submarkets rather than a lack of interest from local, regional and national retailers. Fitness chains have been aggressively pursuing new locations. Crunch and Planet Fitness both opened new locations in Oceanside recently, and Chuze Fitness now has more than five locations around the region. Newcomer EOS Fitness also has near-term plans to expand into San Diego.

3.5%	$23.00	187,229	136,140,376	743,094
VACANCY	AVG. SF RENTAL RATES	NET SF ABSORPTION	RETAIL SF INVENTORY	SF UNDER CONSTRUCTION

WEST REGION - FEATURING SAN DIEGO (continued)

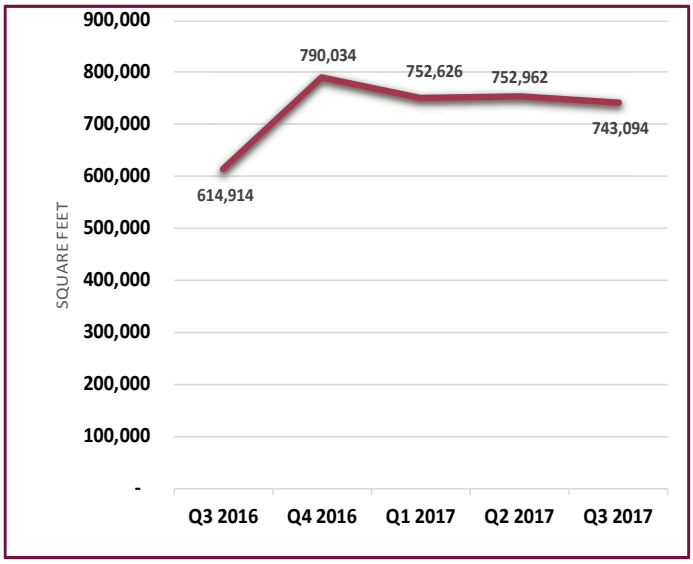
The vacancy rate fell for the sixth time in the last seven quarters, shedding 10 basis points to just 3.5%, the lowest level since 2007. But, the flight to quality, which has been underway for some time, has skewed the distribution of vacant space to lesser quality locations. Retailers are also becoming more cautious in their site selection and are less inclined to take a chance on a marginal location these days. Use overlap is becoming a problem in some centers, as well, leaving many spaces vacant for longer periods. As we reported last period, shopping centers in coastal submarkets are seeing the highest occupancy, while inland centers face more of a challenge filling their vacancies. That has encouraged more landlords to consider other quasi-retail uses to get their centers leased up even though they may not generate the preferred type of retail traffic.

AVERAGE SF RENTAL RATES



Average asking rental rates moved up again in Q3, rising $.19 to $23 per square foot. Year-over-year rent growth hit 4.3%. Power Center rents lead all retail product types with a rate of $28.65, unchanged in the period, but up $1.18 since this time last year. Discounters like Dollar General and 99 Cents Only, who are motivated to keep opening stores in San Diego, may soon be priced out of the market as they were back in 2007.

SF UNDER CONSTRUCTION



The big unknown in retail right now is the potential impact recreational marijuana growers and retailers will have on the commercial property market. Interest from this new category is very strong, but many believe that state is behind schedule in setting up the bureaucratic infrastructure needed to process and issue the necessary licenses and regulate the industry. Municipalities are also faced with the daunting challenge of deciding just how many marijuana operators they will allow in their cities, and under what restrictions they will be allowed to operate. Landlord sentiment is mixed, but those who own B and C quality centers with higher vacancy appear to be the most receptive to this new industry. A looming problem is the attitude of retail property lenders, many of whom have the right to approve leases in centers securing their loans. They are concerned about the fact that marijuana is still an illegal drug at the federal level.

WEST REGION - FEATURING SAN DIEGO (continued)

A LOOK AHEAD

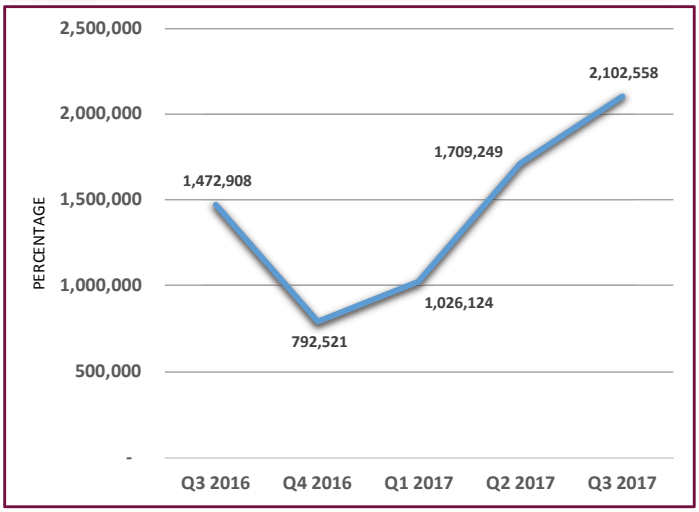
- Net absorption will remain constricted by limited supply
- Construction will be concentrated in retrofit projects rather than ground-up development
- Quasi-retail, recreational uses will account for more of the leasing activity in B and C centers
- The vacancy rate will continue to decline at modest pace
- Average asking lease rates will be relatively flat over the next several quarters
- Sales prices for owner/user buildings will keep going higher as long as the cost of capital remains near current levels

Regional Snapshots Around the West

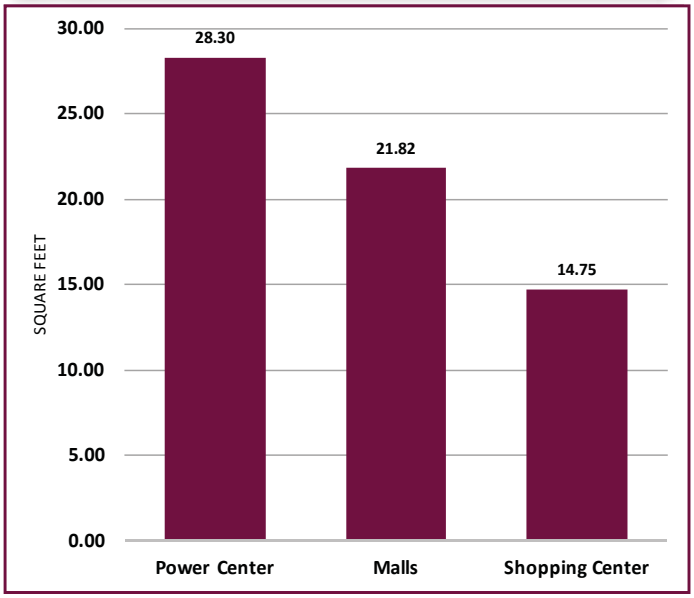
REGION	VACANCY %	AVG RR/SF	NET ABSORPTION	INVENTORY	UNDER CONSTRUCTION
Boise	5.30%	$12.80	(17,759)	39,775,751	43,719
Denver	4.90%	$17.68	437,357	199,434,511	2,011,738
East Bay/Oakland	3.50%	$25.57	(113,510)	121,317,504	689,624
Inland Empire	7.50%	$17.15	235,661	188,598,263	1,530,209
Los Angeles	4.00%	$30.70	829,624	476,168,414	1,933,900
Orange County	4.10%	$25.95	(6,629)	143,752,962	603,508
San Diego	3.50%	23.00	187,229	136,140,376	743,094
Seattle	3.70%	$19.51	305,613	175,801,536	736,924
Stockton	3.50%	$14.99	521,969	56,557,013	73,293

SOUTHWEST REGION - DFW

YEAR TO DATE DELIVERIES



AVG SF RENTAL RATES - CENTER TYPE



TRENDING IN Q3

- Vacancy down slightly year-over-year
- Average asking rental rates unchanged in Q3
- Net absorption highest in last four quarters
- New deliveries hit 2-year high
- Power Center rents down on the year

The Dallas/Fort Worth area (DFW) is still one of the fastest growing regions in the country. Strong population and job growth provide constant support of gains in retail sales. Major employers continue to choose DFW over other major metro areas for major business expansion, including Toyota, JP Morgan Chase and State Farm Insurance. They like the regulatory environment, tax incentives for job creation, lack of a state income tax and healthy supply of affordable housing for their employees.

The retail vacancy rate has been declining consistently from a recession-high 8.7% back in Q4 of 2010 to just 4.8% by the end of the most recent period. However, the pace of decline has moderated over the past year, falling just 10 basis points since this time last year. That has more to do with limited supply of quality space than it does a lack of tenant demand. Vacancy in the Shopping Center category, which includes 154 million square feet of Community, Neighborhood and Strip Centers, is highest at 8.5%. All other retail product categories have less vacancy rates under 3%.

Base inventory stands at just under 420 million square feet in 31,259 buildings. New deliveries for the entire region in Q3 included 64 buildings totaling over 2.1 million square feet, up from 1.7 million square in Q2.

4.8%	$16.01	1,866,561	419,986,650	5,355,061
VACANCY	AVG. SF RENTAL RATES	NET SF ABSORPTION	RETAIL SF INVENTORY	SF UNDER CONSTRUCTION

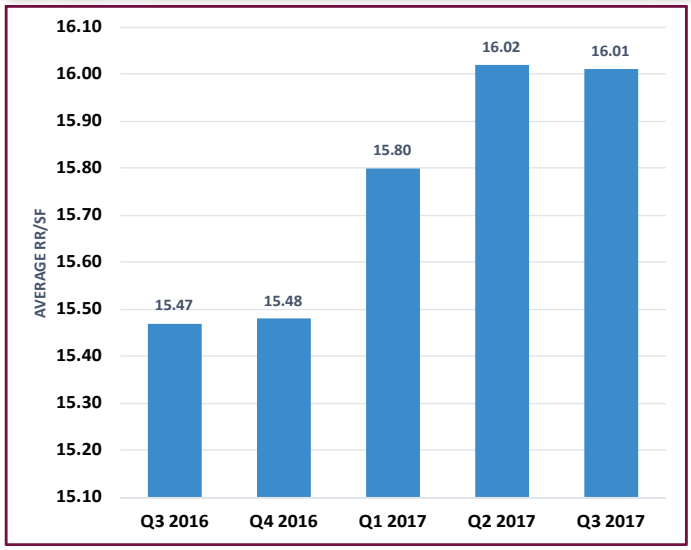
SOUTHWEST REGION - FEATURING DFW (continued)

In the past year, over 5.6 million square feet of new retail space has been added to inventory. Significant deliveries in Q3 included Phase 1 of The Shops at Clearfork in the Central Fort Worth submarket, a 335,219-square-foot project that is 100% leased, and 180 Crown Pointe Blvd in the Suburban Fort Worth submarket, a 215,622- square-foot-project that is now 85% occupied. Of the fifteen largest projects delivered so far this year, fourteen are 100% leased, which indicates continued high confidence in the DFW area from a wide variety of retailers.

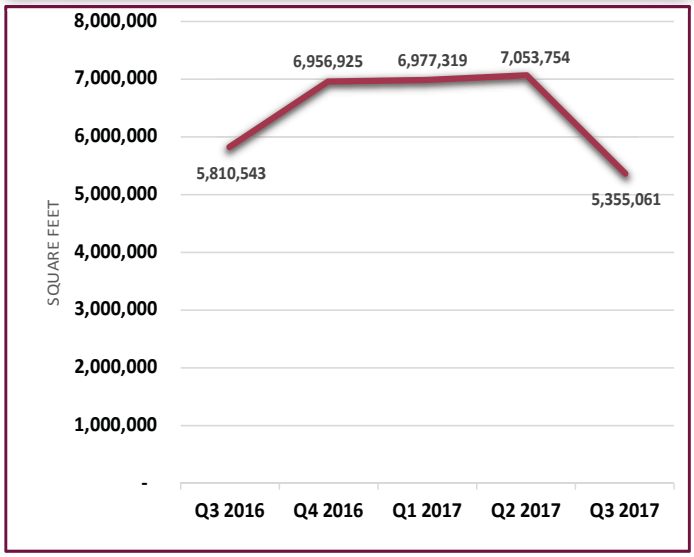
Net absorption has slowed in the first three quarters of 2017 compared to the same period last year. But, this period's net gain of almost 1.9 million square feet was the best since Q3 of last year. There was good news for Power Center owners in Q3. Over 518,000 square feet of net absorption was reported after multiple quarters of light occupancy gains. Power Centers across the country have been hit hard by changing brick-and-mortar formats from many of the big box retailers who have been adversely impacted by growth in online sales.

The combined average asking lease rate for all retail categories in Q3 was down a penny to $16.01, but up $.54 year-over-year and $.98 since Q1 of 2016. Power Center rental rates are still highest at $28.30 but are down by $1.39 year-over-year. As we have been reporting, the Power Center sector is still feeling the loss of many big box retailers who have been forced to reduce their brick-and-mortar footprints in response to competition from online retailers like Amazon.

AVG SF RENTAL RATES ALL PRODUCT TYPE



SF UNDER CONSTRUCTION



Mall asking rents in the region moved up again in Q3, marking the third straight quarterly gain after suffering three consecutive quarterly declines before that. By the end of Q3, the average rate moved up by $.22 to $21.82. DFW's malls continue to outperform those in many other major metro areas across the country that have been losing major anchor tenants like Macy's, Sears and JC Penney.

SOUTHWEST REGION - FEATURING DFW (continued)

A LOOK AHEAD

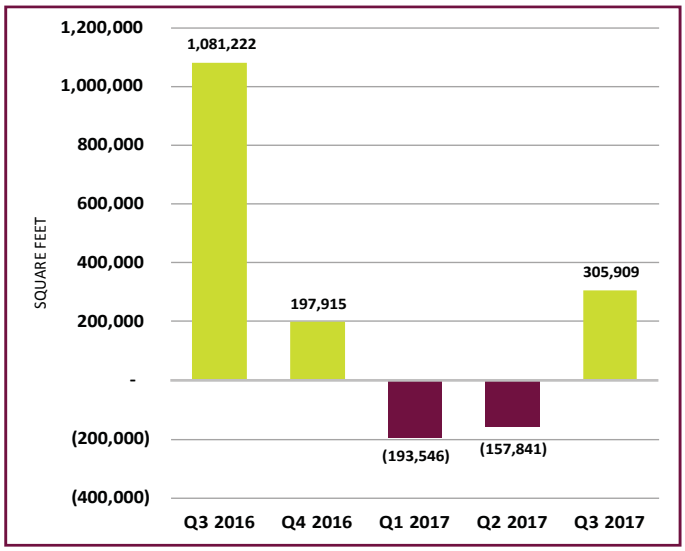
- Lease and sale activity will remain near current levels
- Net absorption will make modest gains next year
- Vacancy rate will continue to decline
- Construction activity should increase slightly next year
- Pace of rent growth will moderate

Regional Snapshots Around the Southwest

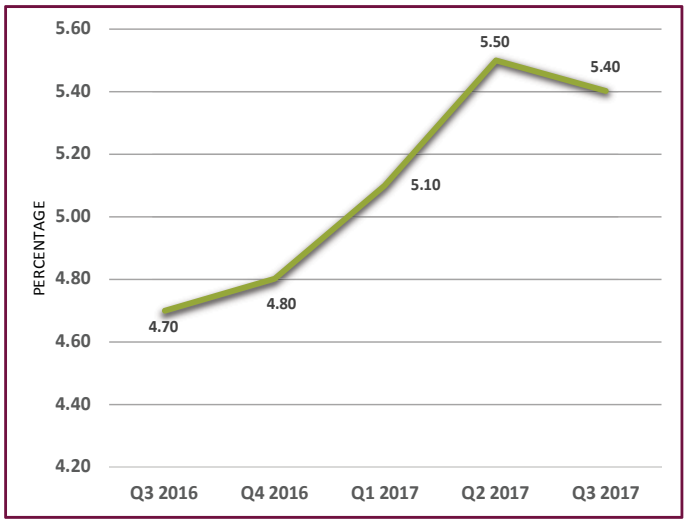
REGION	VACANCY %	AVG RR/SF	NET ABSORPTION	INVENTORY	UNDER CONSTRUCTION
Dallas/Fort Worth	4.80%	$16.01	1,866,561	419,986,650	5,355,061
Houston	5.40%	$16.43	1,767,519	37,920,950	3,939,401
Phoenix	8.40%	$15.12	1,815,166	225,800,489	1,409,096

MIDWEST REGION - INDIANAPOLIS

NET SF ABSORPTION



VACANCY RATE



TRENDING IN Q3

- Grocery and restaurant expansion fuels the market
- CBD and suburban core submarkets see most of the action
- Net absorption returns to positive territory
- Average asking rents move higher
- Vacancy back on the decline, but still up for the year

Indianapolis retails continue to benefit from strong economic growth throughout the Indianapolis metro area, which is now home to more than two million people. The general economy is good and getting better, boosted by growing tech and pharma sectors. Salesforce.com recently purchased locally-based Exact Target and then committed to a 350,000-square-foot office lease in Downtown Indianapolis that is sure to give retailers there a big boost. Indianapolis is also home to Eli Lily, one of the world's largest pharma corporations.

For the last several years, multi-family development has been on a roll in response to shifting demographics, especially in the CBD and suburban core areas. Baby boomers leaving the workforce in record numbers have given way to millennials who prefer urban environments with walkable amenities. Today's younger generation is less enamored with home and automobile ownership, preferring to move between live, work and play environments on foot or by way of public transport. Mixed-use projects containing retail space and residential units are becoming more common. Square, a 28-story multi-family project downtown.

5.4%	$12.64	305,909	127,540,234	740,759
VACANCY	AVG. SF RENTAL RATES	NET SF ABSORPTION	SF INVENTORY	SF UNDER CONSTRUCTION

MIDWEST REGION - FEATURING INDIANAPOLIS (continued)

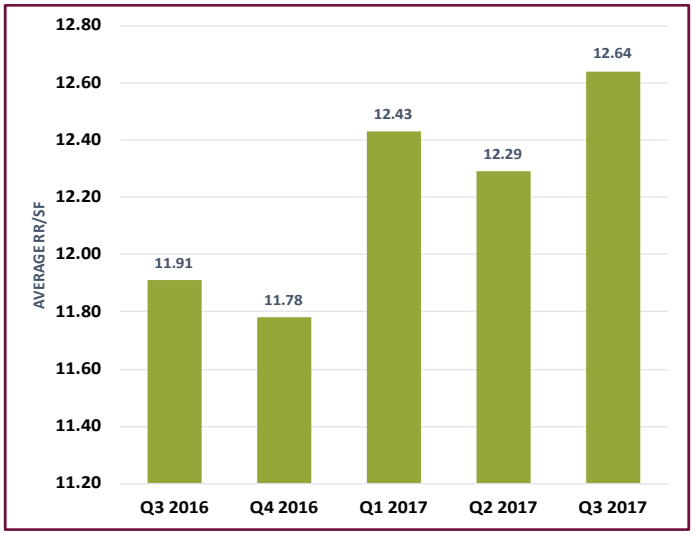
Whole Foods is currently building out its third regional location on the ground floor of 360 Market Square, a 28-story multi-family project downtown.

It's all about restaurants and grocery stores when it comes to leasing activity. Both sectors are expanding aggressively in close-in submarkets. Fast casual dining establishments and micro chains are boosting activity in spaces under 10,000 square feet, especially locations in proximity to multi-family developments. Cunningham Restaurant Group and Kimball-Musk are two of those most active players in this sector.

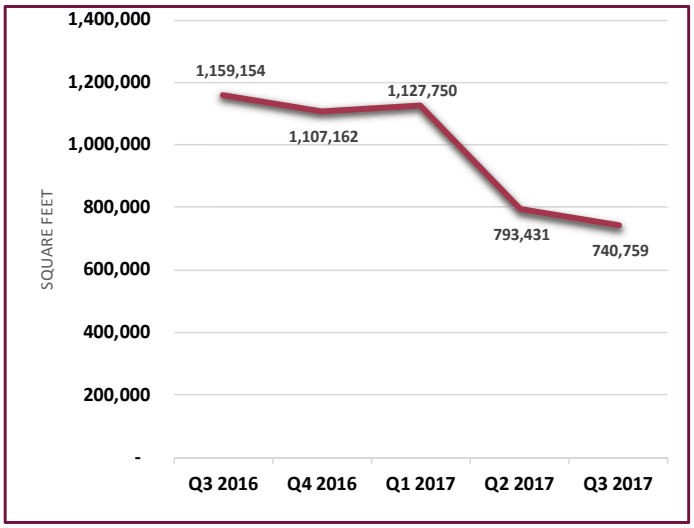
The region was rocked by the recent bankruptcy of Marsh Supermarkets, a huge player in the grocery business throughout the region for decades. The closure of all Marsh locations definitely impacted market metrics, causing consecutive quarters of negative net absorption and a higher vacancy rate. Fortunately, some other big players in the grocery business see those empty stores as a huge opportunity and they are gobbling up locations. Kroeger's has committed to 11 of Marsh's locations and Ohio-based Fresh Encounter, has signed on for another 17. The remaining empty Marsh stores, most in outlying traditional submarkets, will take a while to get leased due to a change in demographic profiles preferred by today's grocers.

Another high profile bankruptcy also hit Indianapolis this year. HH Gregg, a 220 store electronics retailer, headquartered in Indianapolis, was forced to close all its stores due to sagging sales. That has put heavy vacancy pressure on owners of big box retail centers, offsetting strong growth in other retail sectors. In other markets across the country, fitness centers have been backfilling big box spaces, but Planet Fitness and other major fitness operators were already fully deployed. The recent entry into the Indianapolis market by Ross Dress for Less may help absorb some of the slack in big box vacancy. The major national chain has decided to take on Marshalls/Home Goods, which currently dominates that retail category.

AVERAGE SF RENTAL RATES



SF UNDER CONSTRUCTION



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MIDWEST REGION - FEATURING INDIANAPOLIS (continued)

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Net absorption was very strong in Q2, posting a gain of 447,414 square feet in large part due to the 192,000-square foot lease to Meijer at 5550 N Keystone Ave and Costco's 148,000-square-foot deal at 4616 E County Line Road. Year-over-year gains in occupied space have been solid at 966,301 square feet. Leasing in mixed-use projects in suburban markets remains at a slow but steady pace. Structured parking is still a "new" thing for retailers and some have not fared well in those projects. Owners of these properties will need to redouble their efforts to gain acceptance of a retail trend that is sweeping the nation.

A LOOK AHEAD

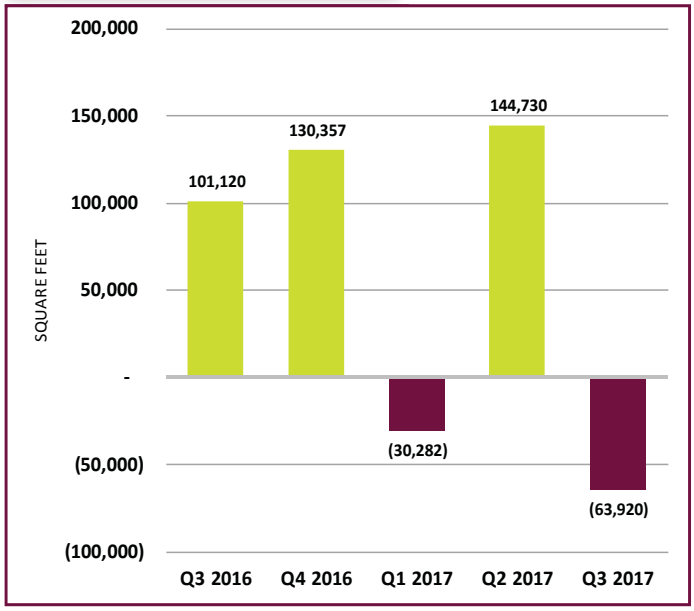
- Lease activity will remain strong for the next several quarters
- Overall vacancy will decline, but areas with functionally obsolete space will struggle to increase occupancy
- Net absorption will increase as Marsh vacancies are filled in prime areas
- Overall economic growth will continue to accelerate in 2018
- Transaction activity in prime submarkets will be restricted by tightening supply
- Construction activity will cool off in the coming quarters, with most new projects coming on line that are mostly preleased
- Asking lease rates will continue to increase, largely due to rising construction costs

Regional Snapshots Around the Midest

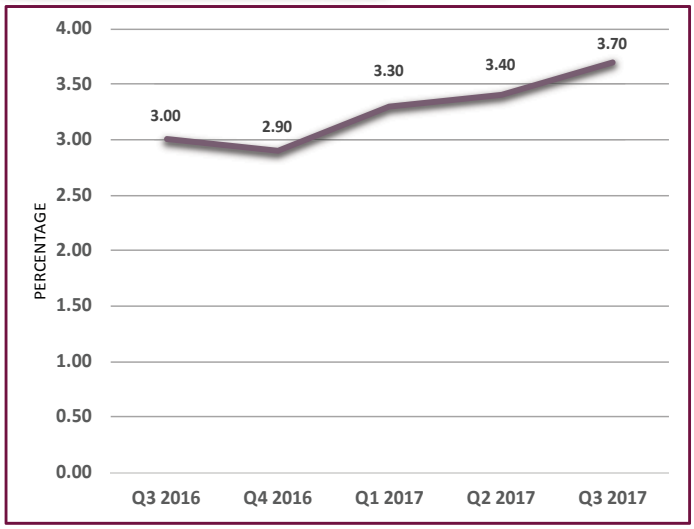
REGION	VACANCY %	AVG RR/SF	NET ABSORPTION	INVENTORY	UNDER CONSTRUCTION
Chicago	6.70%	$15.89	261,758	550,306,308	2,570,996
Cleveland	5.50%	$10.48	(626,705)	204,669,461	1,198,659
Columbus	4.30%	$12.19	625,707	93,733,978	368,046
Detroit	5.90%	$13.19	1,961,416	277,309,820	1,193,537
Indianapolis	5.40%	$12.64	305,909	127,540,234	740,759
Madison	3.10%	$12.96	687,669	44,242,401	552,399
Minneapolis	3.20%	$14.34	744,521	205,931,812	677,429
St. Louis	5.00%	12.28	691,953	162,567,370	152,940

SOUTH REGION - CHARLESTON

NET SF ABSORPTION



VACANCY RATE



TRENDING IN Q3

- Average asking lease rates hit new high
- Shake-up in big box retailing pushes vacancy up
- Mt. Pleasant gets new mayor who says no to new development
- Volvo plant fueling housing and retail growth
- Population growth remains strong

Summerville and North Charleston are getting a lot of attention these days, as the new Volvo assembly plant, the nation's second largest industrial development project, has emboldened residential and retail developers to run in high gear. Retailers looking to meet the anticipated increase in retail spending are aggressively pursuing new locations there. The expanding Port of Charleston is also a major contributor to regional economic growth, helping Charleston's become one of the fastest growing metro areas in the south. Travel & Leisure and Conde Naste keep naming Charleston the nation's best city for its legendary charm and variety of luxury and tourist-class hotels. Approximately 700,000 residents live in the region and the population is growing at an estimated rate of 43 residents per day.

The vacancy rate is relatively low compared to the majority of metro areas around the country, and landlords still maintain the upper hand when negotiating tenant improvements and other concessions. However, vacancy has been trending up this year, ending Q3 at 3.7%, up 30 basis points in the period and 70 basis points year-over-year. With a base inventory of just under 44 million square feet, significant swings in vacancy are to be expected, as one or two large move-outs in a single quarter can

3.7%	$22.26	(63,920)	43,949,609	334,089
VACANCY	AVG. SF RENTAL RATES	NET SF ABSORPTION	RETAIL SF INVENTORY	SF UNDER CONSTRUCTION

SOUTH REGION - FEATURING CHARLESTON (continued)

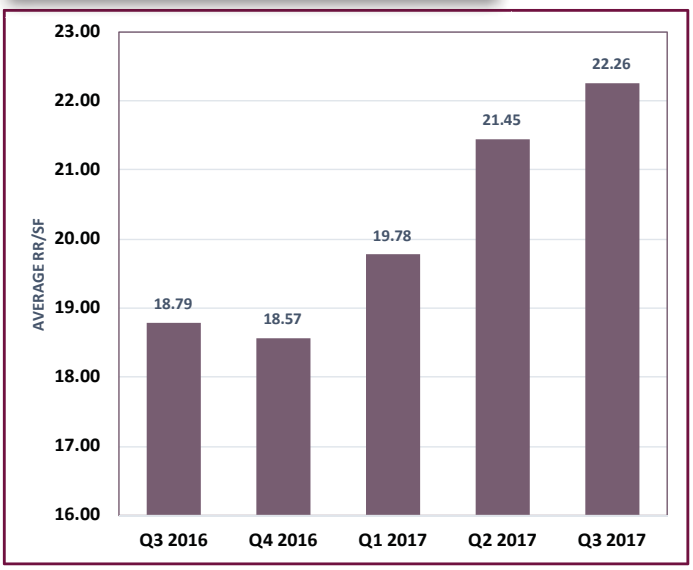
significantly move the vacancy needle. This has been the case in Charleston of late as legacy department store anchors have closed stores as part of their overall strategy to change their business models occasioned by the prolific growth in online retailing. A good example is the backfilling of a former JC Penny store by the Medical University of South Carolina at the Citadel Mall, which was recently acquired through a receivership.

Low vacancy has also allowed landlords to insist on higher lease rates. The overall average asking lease rate rose sharply for the third consecutive period, gaining another $.81 to $22.26, after a Q2 increase of $1.67 and a rise of $1.21 in Q1. That helped bring the year-over-year asking rate up by a robust 18.47%, one of the highest growth rates in the country. Strong demand from the grocery and restaurant categories is helping to drive that rise in rents. Aldi Leidel, Publix and Teeter Harris are grocers on the move, while fast casual restaurants, both locally and nationally based, are driving demand in the retail dining sector. New breakfast concepts from the likes of Famous Toastery and First Watch are also in expansion mode.

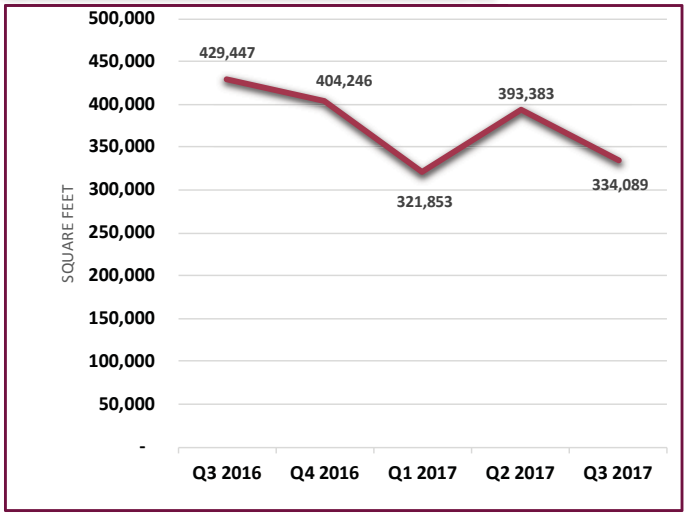
Net absorption gains have been modest over the past two years, but that may be due more to a lack of supply in the most popular submarkets than it is the level of demand. Quality space in prime submarkets like Mount Pleasant, Summerville and Downtown Charleston is running thin.

Absorption slipped into negative territory in Q3, declining by 63,900 square feet after a 144,730-square-foot net gain in the previous quarter.

AVERAGE SF RENTAL RATES



SF UNDER CONSTRUCTION



Increasing traffic congestion and aesthetic concerns have encouraged local governments to rein in new development. In the most recent election, Mt. Pleasant elected a new mayor who ran on a platform of putting the brakes on further commercial development in that city. In Q3, new deliveries declined to just 71,380 square feet from 208,064 square feet in Q2. Another 334,089 square feet is still under construction.

SOUTH REGION - FEATURING CHARLESTON (continued)

A LOOK AHEAD

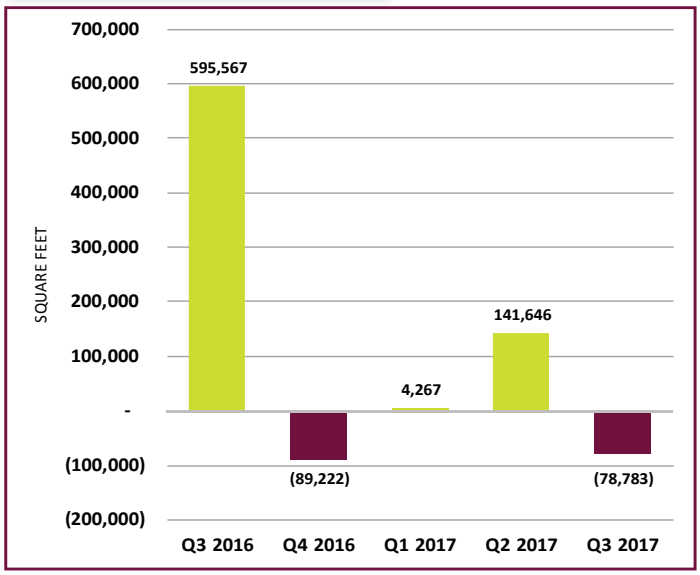
- Overall lease and sale activity should remain near current levels heading into next year
- Net absorption growth will remain tepid due to ongoing supply issues
- Retailers will aggressively pursue new locations near new multi-family projects that have become popular with younger shoppers
- Vacancy will stay in the 3% range in 2018
- Strip Center owners will cater to service tenants that are not impacted by online retailers
- Construction activity will experience a decline heading into next year
- Going forward, construction activity will be primarily in renovation and repositioning projects

Regional Snapshots Around the South

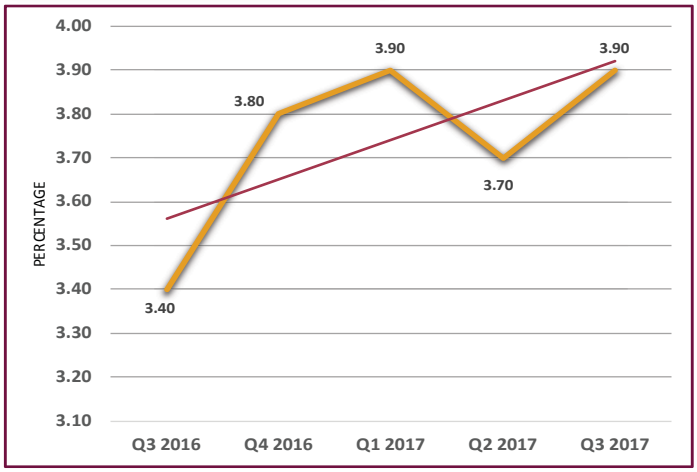
REGION	VACANCY %	AVG RR/SF	NET ABSORPTION	INVENTORY	UNDER CONSTRUCTION
Atlanta	5.60%	13.62	494,060	363,158,847	1,867,130
Charleston	3.70%	22.26	(63,920)	43,949,609	334,089
Greenville	4.90%	11.28	(88,226)	86,784,983	332,990
Orlando	4.60%	$16.40	1,604,684	169,282,521	1,427,855

EAST REGION - MANHATTAN

NET SF ABSORPTION



VACANCY RATE



TRENDING IN Q3

- Average asking rents keep moving lower
- Availability rate rises again
- Retail market correction continues despite record tourism
- Job and wage growth picks back up
- Retail sales growth still on track to best 2016 level

The Manhattan retail market continues to adjust to changing retail trends, as major retailers execute new strategies to combat the prolific rise in on-line retail sales and adjust to demographic shifts. Until last year, leasing activity was brisk, vacancy was falling and rents were moving higher. But, in the last year, the retail market has been going through a natural correction that often follows a prolonged market expansion. That has led to a decline in lease rates and a substantial uptick in available space.

Even though the overall economy in Manhattan remains in good health, job growth this year has been spotty and its good-paying jobs that generate increases in retail sales. In all of New York City, just over 48,000 jobs were added in the last year, down from 87,000 in the previous twelve months. That expanded the region's workforce by another 1.3% and keeps the city on par with the national labor market growth trajectory. The biggest gains this year have come in the educational and health services, professional and business services, and leisure and hospitality sectors.

Retail market metrics point to further declines in average asking rents. Of the 14 major retail

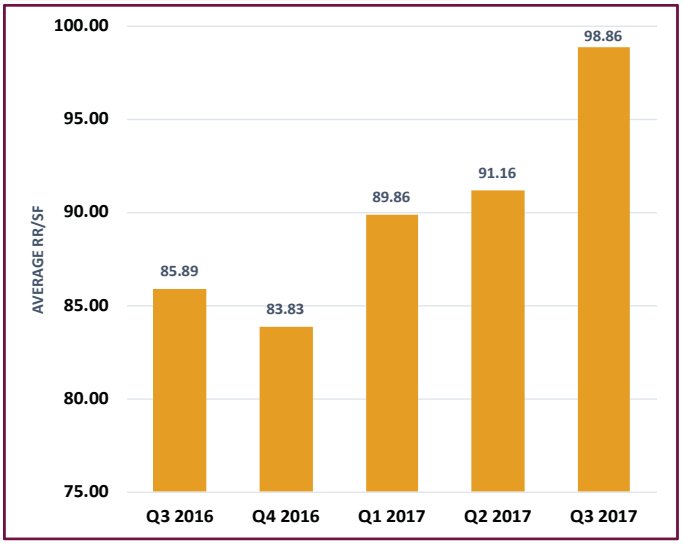
3.9%	$98.86	(88,226)	86,784,983	332,990
VACANCY	AVG. SF RENTAL RATES	NET SF ABSORPTION	SF INVENTORY	SF UNDER CONSTRUCTION

EAST REGION - FEATURING MANHATTAN (continued)

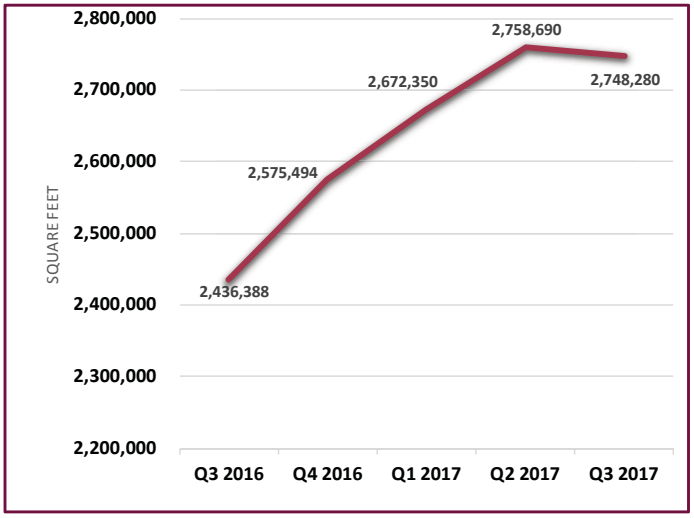
corridors tracked by Lee & Associates, all reported year-over-year declines in average asking rents. The biggest drop occurred in the Bleecker Street/ Seventh Ave So. to Houston Street corridor where rents have decreased by 27% in the past year. The Broadway/ 14th to 23rd Streets corridor suffered a 22% decline in the same period. The Fifth Ave/14th to 23rd Streets corridor, by contrast, recorded an 18% rise in asking rents in the most recent four quarters. The Broadway/ Battery Place to Chambers Street corridor managed an 11% increase in asking rents in the same period. Important note: rents quoted are asking rents for currently available spaces. The physical components and location of any retail space factors greatly into its market rental value.

There were some significant deals in the news this quarter. Amazon made headlines in Manhattan in a couple of ways. The ecommerce giant committed to a lease for 392,000 square office space that will lead to as many as 2,000 new high-paying jobs, and also announced its third physical space bookstore on Spring Street between Crosby and Lafayette Streets. The new location will include over 7,000 square feet on two levels. The other two stores are located in Time Warner Center and Herald Square.
Another major retail deal making the news in Q3 was the announcement by Parques Reunidos, a Spanish amusement company, of its plans to collaborate with Lionsgate Entertainment on a new movie-themed food and entertainment venue at 11 Times Square. The project will require $30 million and two years to complete, and will open as the first Lionsgate Entertainment City in 2019.

AVERAGE SF RENTAL RATES



SF UNDER CONSTRUCTION



EAST REGION - FEATURING MANHATTAN (continued)

A LOOK AHEAD

- Expect further declines in lease rates heading into next year
- Service-related uses will continue to replace more traditional product-based retailers
- Availability will continue to rise in most retail corridors

Regional Snapshots Around the East

REGION	VACANCY %	AVG RR/SF	NET ABSORPTION	INVENTORY	UNDER CONSTRUCTION
Baltimore	3.60%	$18.71	210,159	140,113,755	695,191
Long Island/Queens	3.70%	$34.52	(768,861)	321,487,785	3,369,828
New Jersey	4.90%	$21.14	289,264	389,978,659	3,955,127
New York City	3.90%	$98.86	67,130	53,528,667	2,748,280

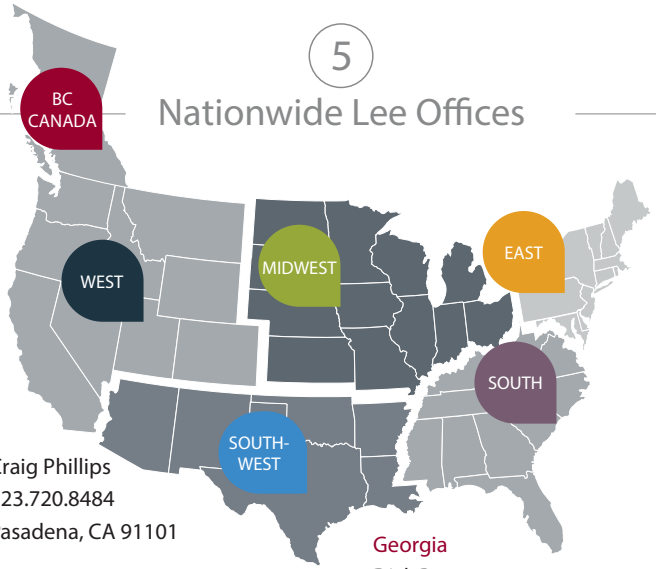
SELECT TOP RETAIL LEASES Q3 2017

BUILDING	MARKET	SF	TENANT NAME
200 Southdale Ctr	Minneapolis	120,000	LifeTime Fitness
15201 N. Cleveland Ave	Southwest Florida	107,806	Sears
Baker Hill Center	Chicago	72,397	Pete's Fresh Market
101 Rice Lake Square	Chicago	67,383	Pete's Fresh Market
Cypress East Shopping Center	Orange County, CA	67,000	Hobby Lobby
8543 Church Ranch Blvd	Denver	57,816	VASA Fitness
Renaissance Marketplace	Inland Empire	56,561	Cinemark
3701 Countryside Dr	Stockton	55,000	Hobby Lobby
W. Ashley Cir	Charleston	50,000	Harris Teeter

SELECT TOP RETAIL SALES Q3 2017

BUILDING	MARKET	SF	PRICE PSF	CAP RATE	BUYER	SELLER
The Shoppes at English Village	Philadelphia	103,188	$552.39	5.45%	MetLife Real Estate	Stanbery Development
Hickory Ridge Shopping Ctr	Charlotte	380,487	$115.69	8.65%	Acadia Realty Trust	Retail Properties of America
Gateway Marketplace	San Diego	127,943	$328.27	5.62%	American Assets Trust	Brixton Capital AC, LLC
Maynard Crossing	Raleigh/Durham	122,781	$238.60	6.0%	New Market Properties	Regency Centers Corp
5975 Canal Rd	Cleveland	126,456	$222.21	7.6%	EPR Properties REIT	Stark Enterprises
New Towne Plaza	Detroit	193,446	$134.40	8.31%	Acadia Realty Trust	Ramco-Gershenson

Nationwide Lee Offices



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