The Lee Retail Brief

Q4 2016

LEE & ASSOCIATES®

COMMERCIAL REAL ESTATE SERVICES

Lee & Associates Overview

155%
increase
in transaction volume over 5 years

$12+ billion
transaction volume
2015

Ranked 2nd
june 2016
Commercial Property Executive
(2016 Top Brokerage Firms)

887
agents
and growing nationwide

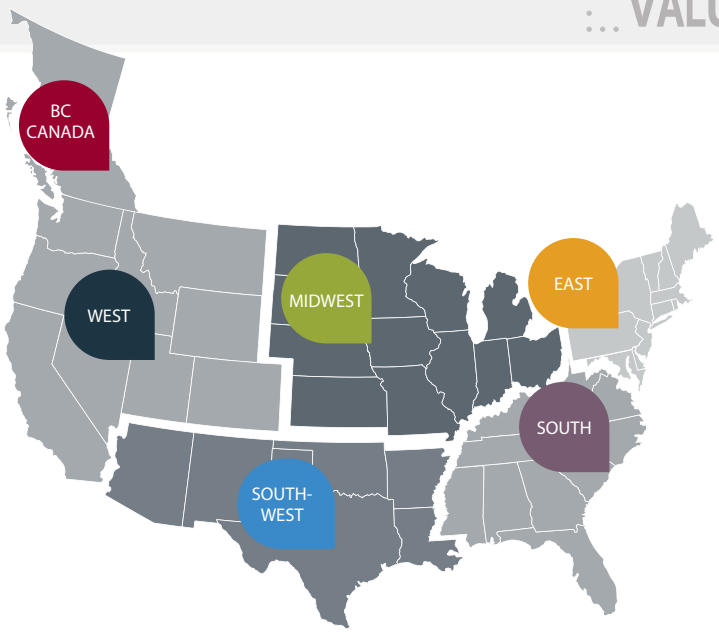
LOCAL EXPERTISE. NATIONAL REACH. WORLD CLASS.

At Lee & Associates® our reach is national but our expertise is local market implementation. This translates into seamless, consistent execution and value driven market-to-market services.

Our agents understand real estate and accountability. They provide an integrated approach to leasing, operational efficiencies, capital markets, property management, valuation, disposition, development, research and consulting.

We are creative strategists who provide value and custom solutions, enabling our clients to make profitable decisions.

OFFICE
INDUSTRIAL
RETAIL
INVESTMENT
APPRAISAL
MULTI-FAMILY
LAND
PROPERTY MANAGEMENT
VALUATION & CONSULTING



THE POWER OF THE LEE NETWORK

Irvine, CA
Orange, CA
Newport Beach, CA
Ontario, CA
Riverside, CA
Los Angeles, CA
Industry, CA
Carlsbad, CA
Stockton, CA
Pleasanton, CA
West LA, CA

Sherman Oaks, CA
Central LA, CA
Temecula Valley, CA
Victorville, CA
Calabasas, CA
Los Olivos, CA
San Luis Obispo, CA
Ventura, CA
San Diego, CA
Reno, NV
Oakland, CA

Antelope Valley, CA
Santa Barbara, CA
Palm Desert, CA
ISG- LA, CA
Boise, ID
Long Beach, CA
Denver, CO
Pasadena, CA
Walnut Creek, CA
Seattle, WA

Phoenix, AZ
Dallas/Ft Worth, TX
Houston, TX

Chicago, IL,
St. Louis, MO
Southfield, MI
Madison, WI
Indianapolis, IN
Greenwood, IN
Cleveland, OH
Columbus, OH
Twin Cities, MN

Atlanta, GA
Greenville, SC
Fort Myers, FL
Orlando, FL
Charleston, SC
Valuation, Atlanta

Elmwood, NJ
Manhattan, NY
Edison, NJ
Chesapeake Region
LI/Queens, NY
Eastern Pennsylvania

Vancouver, BC
Canada

US RETAIL MARKET

RETAIL SECTOR STAYS ON COURSE IN Q4

The US retail property market kept pace in Q4. Vacancy and construction activity were relatively unchanged, rents rose modestly and net absorption remained solidly in positive territory. Even though the numbers point to market consistency, the retail industry continues to experience significant change as traditional department stores struggle to adjust to the massive challenge presented by growth in online sales and the demographic shift from baby boomers to millennials.

Macy's announced that it will close 68 more stores in 2017, displacing thousands of workers, and the company will also be selling off valuable real estate assets. Sears Holding Corporation plans to close another 150 Sears and K-Mart stores due to lagging sales and it recently announced the sale of its iconic Craftsman tool brand to Stanley Black & Decker. Walmart is making big moves to compete more effectively with e-commerce behemoth, Amazon, which continues to expand at amazing speed. In 2016, Walmart acquired Jet.com to enhance its online capabilities and it is leasing major distribution facilities around the country to increase "last mile" efficiency. In recent weeks, the world's largest retailer also announced further job cuts on the administrative side as part of its ongoing efforts to improve operating efficiency. Office Depot is also feeling the pinch from increased online competition. The office products giant decided in 2016 to consolidate operations by closing 300 more locations across the country.

Other national retailers called it quits by the end of the year. Sporting goods operators Sport Chalet and Sport's Authority shuttered all their stores in 2016, as did women's apparel giant, The Limited, which will remain in business as an online-only retailer.

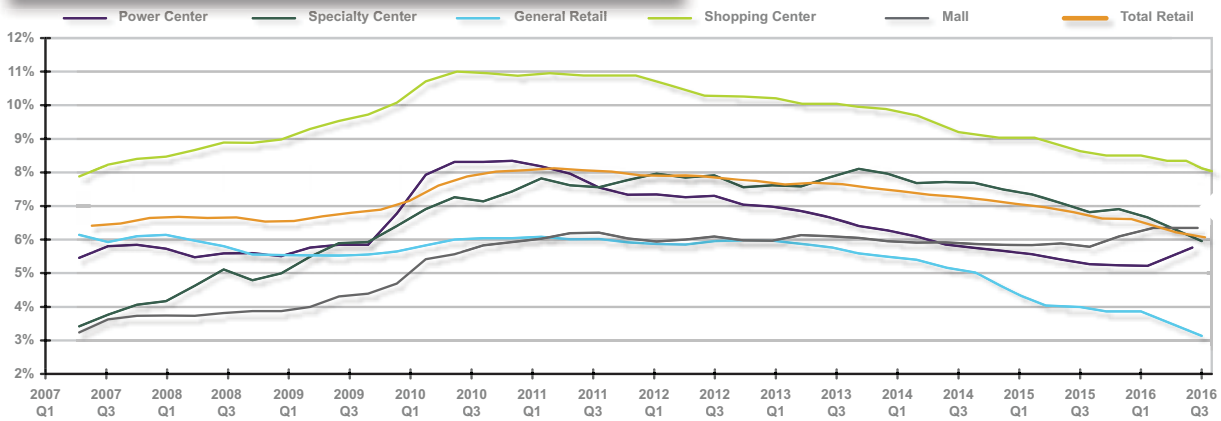
According to a recent report from the National Retail Federation, holiday retail sales numbers for November and December exceeded expectations with a 4% year-over-year increase to $658 Billion.

ECONOMIC DRIVERS

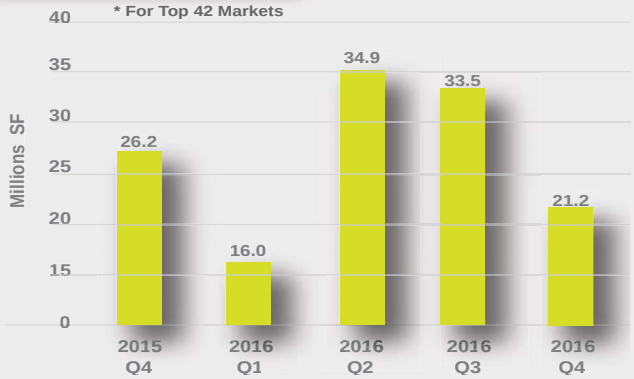
- GROWTH
- EMPLOYMENT
- MONETARY POLICY
- GLOBAL ECONOMY

- A LOOK AHEAD

VACANCY RATES BY BUILDING TYPE 2006-2016



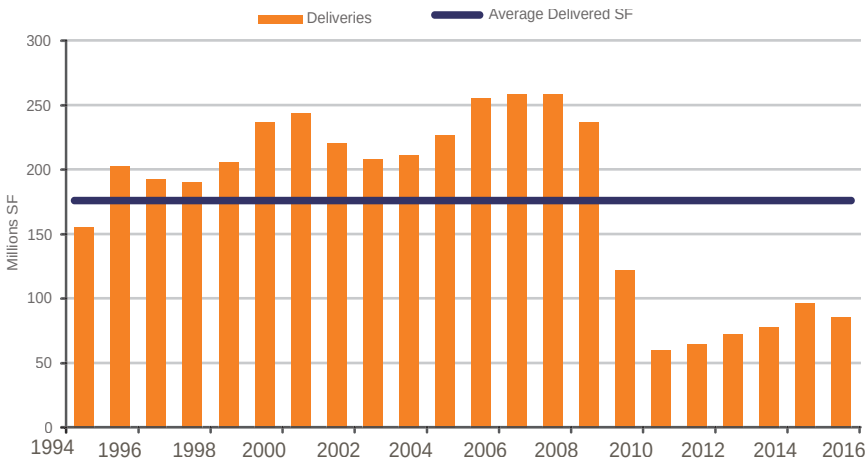
NET ABSORPTION



The increase came despite a 7% decline in department store sales, but better than expected e-commerce sales offset the falloff. US retail sales picked up late in the year. December's rise was .6%, bringing year-over-year growth to 4.1%. That, combined with stronger wage growth in the final quarter of the year, bodes well for overall retail sales in 2017.

The vacancy rate was unchanged in Q4 at 4.9%, but it has fallen by 50 basis points since the end of Q1. As reported last quarter, vacancy is sharply higher in secondary submarkets. General retail (freestanding, general purpose properties) posted the lowest vacancy of all retail property types at 2.9%, down 10 basis points in the quarter, followed closely by Power Centers at 4.8%, up another 10 basis points in Q4, in part due to more store closures in the sporting goods category. Shopping Center (neighborhood, community and strip centers combined) rates are still highest at 7.9% despite another 10 basis point decline in Q4. Excess supply in this category remains concentrated in traditional suburban submarkets that have more turnover due to a higher concentration of mom & pop tenants.

HISTORICAL DELIVERIES 1994 - 2016



Urban areas continue to account for a greater share of net absorption as retailers continue to shift their marketing focus onto millennial consumers. This group prefers multifamily housing near public transportation, hip restaurants, cool bars and entertainment venues over the sprawling "burbs" they were raised in. They are more inclined to rent than own their homes, prefer Uber to owning their own cars and like the idea of walking to work, restaurants and entertainment venues. As a result, mixed use projects near public transportation tend to have the lowest retail vacancy.

Q4 net absorption totaled 26.9 million square feet in the final quarter of 2016, bringing the net gain in occupied space up to 137.2 million square feet. The General Retail category accounted for almost 78 million of that total, followed by 51 million square feet in the Shopping Center category and 5 million square feet in Malls. Power Centers posted a slight decline in occupied space of 110,000 square feet. These numbers clearly reflect the current trends in retailing: department stores closing, big-box retailers reducing store size and count and the shift to urbanized areas with the most millennial population growth.

The overall average asking rate moved up another $.15 to $15.84 per square foot in Q4. Over the past four quarters, retail rents across all product types and locations moved up by just over 3%, but rent gains are more robust in urban locales. Suburban retail centers continue to see weaker growth and higher vacancy. The rate of rent growth suffers as distance from an urbanized core increases, which reflects the ongoing shift in lifestyle priorities.

New deliveries for the quarter totaled 20.8 million square feet, bringing the total of completed inventory in the past four quarters to 84.1 million square feet. The total of all retail space nationwide stands at 13.1 billion square feet, with another 80 million square feet currently under construction.

A LOOK AHEAD

The US retail market will keep growing, but that growth will remain concentrated in more densely populated areas that have been or are undergoing the gentrification process. GDP and wage growth picked up late last year and that may give retail sales a welcome boost. But, consumer spending and retail sales growth have been uneven and the monthly rate of job creation has slowed from 229,000 a year ago, to just 180,000. If post-election optimism becomes reality in the form of stronger job growth, retail sales could gain momentum. Amazon recently announced that it would be adding another 100,000 full time employees to its ranks by 2018. Other large US corporations have also announced new investment in plant and equipment that will create more jobs.

Imported goods will remain cheap due to the strength of the US dollar, and that will keep the discounters busy expanding their footprints. Central banks around the world have resorted to negative interest rate policies to reduce the risk of a deflationary cycle, but Europe and Asia are showing signs of increasing stability. The US central bank made a move to raise rates In December, but the cost of capital is still relatively low. Further rate hikes are likely and they may impact business expansion later in 2017 and into 2018.

Low oil prices, with us for more than two years now, did not produce the boost in retail sales that was hoped for, and oil prices rebounded somewhat in the last half of the year, which may help energy market economies in 2017. Job growth will need to pick back up again to expect further increases in retail sales. For the time being, vacancy, net absorption and rental rates trends are unlikely to change significantly.

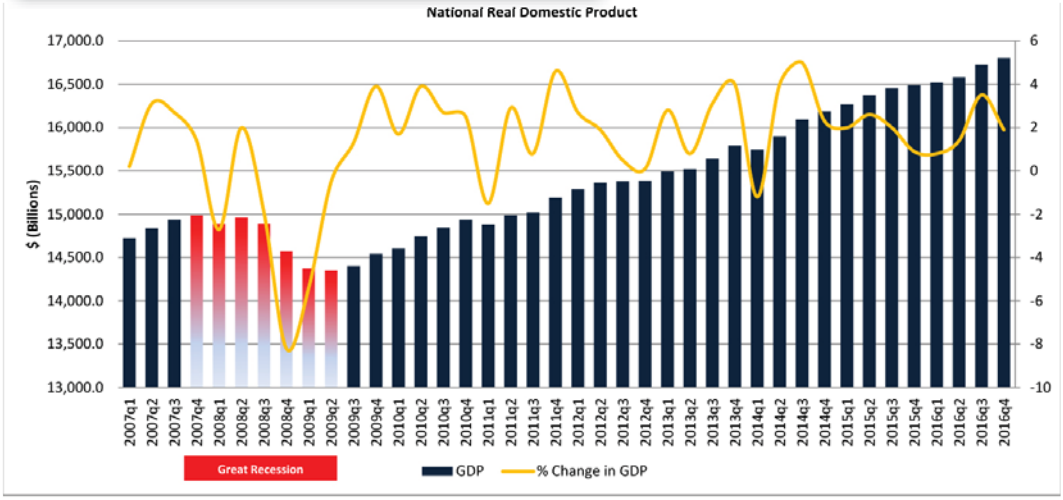
Demand for retail investment properties continues to run well ahead of demand. Cap rates are compressed to record lows, but there is a lot more talk about an investment market that is getting long in the tooth. Through the first nine months of 2016, cap rates for retail investment properties fell another 11 basis points to 7.06%. However, well-located, prime retail properties are trading at cap rates under 5%. Foreign investors will keep giving demand a boost, as they continue to move capital to US markets for safety.

GDP GROWTH

US GDP, the primary metric for tracking the total output of US goods and services, is perhaps the most closely watched statistic in the world. Our economy is, by far, the largest on the planet and we also consume more foreign goods and services than any other nation. Whatever happens here at home, is felt and observed the world over.

Fortunately, US GDP growth picked up in Q3 after several dismal quarterly performances that had the domestic economy running just above stall speed. In Q1, the economy expanded by just .9%, followed by a disappointing 1.4% rate in Q2. The third and final estimate of Q3 growth came in at 3.2%, which had investors breathing a collective sigh of relief. However, a rather obscure but important fact is that the export of soy beans resulting from a poor harvest in South America accounted for more than a fourth of that number.

QUARTER-TO-QUARTER GROWTH IN REAL GDP



Unfortunately, the first estimate of Q4 growth came in at just 1.9%, which left 2016 with a growth rate of just 1.6%. That is good relative to the rest of the world. Europe and Japan are still in tough shape, despite drastic monetary and fiscal measures to keep their economies from sliding into recession.

GDPNow, the Atlanta Fed's weekly index measuring GDP, currently estimates 2.9% growth for Q4. If that proves true, the US economy will at least surpass 2% growth for the year, which is weak, but still on the right side of the line. In 2015, GDP grew at a 2.4% clip.

Even with that decline, the US looks relatively good. Europe and Japan are still in tough shape, despite drastic monetary and fiscal measures to keep their economies from sliding into recession. The central banks in both regions continue their experiment in NIRP (Negative Interest Rate Policy) and they have ongoing and bond-buying programs to encourage businesses to borrow at low or negative rates. Even with all that meddling, GDP growth remains well under 2% in the Euro Area, and the unknown danger associated with unwinding the European Central Bank's monetary experiment is still looming. The Bank of Japan keeps printing money and buying bonds in such volume that it is running out of bonds to buy. So, it has resorted to buying equities to get the stimulus money placed.

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There is no denying the reality of globalization and things are not going well outside our borders. Political turmoil, civil unrest and economic challenges around the world weigh heavy on the minds of domestic investors, and most definitely figure into the strategy of our central bankers.

GDP GROWTH

The question that remains is whether or not US companies and consumers will accept the slower growth model as the "new normal" and act in a way that promotes further growth.

No discussion on economics can be had without considering the newest wild card in global economics: Donald Trump. The US President-Elect stunned the globe with a victory that odds-makers didn't see coming. Neither did Hillary Clinton and her followers, who woke up on November 9th in a world they least expected. Regardless of your political persuasion, there's no denying the immediate effects of the election. Equities markets soared on the expectation of lower corporate and personal income tax rates, reduced regulations and a huge infrastructure spending program. Of course, none of that has yet happened. Mr. Trump will have just taken the oath of office as this writing is released and he will only be beginning to navigate a political system designed to have big change occur over time. Checks and balances built into the US Constitution give the minority protection against being steamrolled. So, our new leader, who is used to calling all the shots when making business decisions, will need some time to acclimate to a different set of rules. But, the preliminary indication from the business world has been positive now that the reality of his victory is sinking in. What impact he can have on GDP in the short run is a complete unknown at this point, but the psychology of decision making going forward may be influenced by the prospects of a more business-friendly President.

Volatility in equities has been on the rise in 2016, as US companies grapple with sluggish market conditions. Corporate earnings have declined repeatedly the last six quarters and companies have been resorting to cost-cutting and stock buyback programs to increase profits and earnings per share. Reducing operating costs means job cuts and that means reduced consumer spending, which accounts for roughly 70% of GDP. Though, it is important to note that the most recent earnings cycle did show signs of improvement.

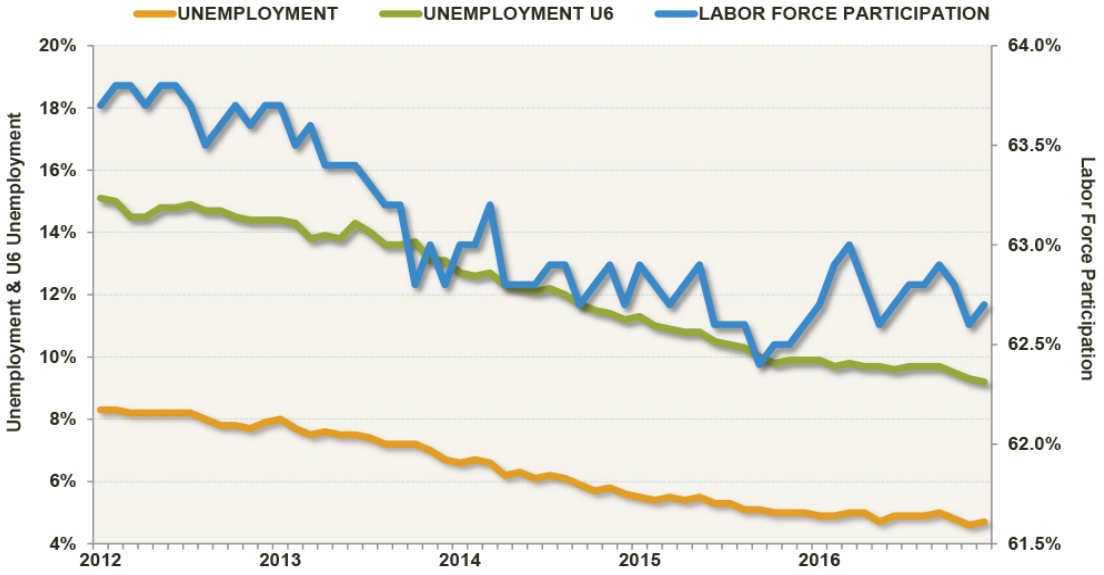
As we have pointed out all year, US consumers have been riding the brakes on spending. Retail sales growth, a large component of consumer spending, has been a problem and wage growth has been lagging behind previous economic recoveries, though it did spike in December to 2.9% year-over-year. Auto sales set a record, but most of a December increase can attributed to incentives to move slow selling vehicles off the lots before the year ended. The bottom line on GDP is that it could go either way. If the Trump effect lasts for a while, business investment and consumer spending could build some momentum and those are the two main components of GDP. If that happens, however, the Fed will make more interest rate moves and that will strengthen the US Dollar and hurt exports, another key component of GDP.

EMPLOYMENT

Job growth is one the most perplexing of economic indicators, especially due to the fact that the U3 unemployment rate is the most widely quoted rate. The base for the U3 rate includes those who are employed and those who are unemployed but have actively sought employment in the last five weeks. We are not sure who made that one up, but we would sure like to know what the logic was. The U3 equation often produces counter-intuitive results. When job creation is good, those who have not been looking for work, re-engage in their search and are added to the total of those who are actively looking, increasing the number of unemployed workers and thereby raising the unemployment rate.

The U6 unemployment rate, presents a different story. It includes those working part time in their field of choice, who would prefer to be working full time, as unemployed. Many believe U6 metrics offer a more accurate employment picture. It does make clearer the frustration of many in the middle class who still feel like the recession never ended. They are technically employed, but don't feel the impact of higher income. This is the group that may have turned the election for Mr. Trump.

NATIONAL UNEMPLOYMENT



U6 unemployment is currently more than double that of U3, at 9.7%. Job creation has been slowing over the past year. The 12 month rolling average has fallen to 180,000 per month from 229,000; not an insignificant number and important to note that it includes part time jobs, most of which are at or near minimum wage. Q4 started strong with a total new job count of 161,000. November hit 178,000 and December came in under estimates at 156,000. The low point for 2016 came in May when only 11,000 new jobs were recorded. The best month of the year thus far came in June, when 271,000 new jobs were created. Wild swings in job growth affect current and future consumer spending, prompting CEOs to be more cautious and less inclined to implement aggressive growth strategies.

Despite erratic job growth numbers, the U3 unemployment rate for December came in at 4.7%, which is generally indicative of a fully employed economy. However, that number is deceiving because so many of the jobs being created are either part time or at the lower range of the wage scale.

The cost of health care pursuant to the Affordable Care Act (ACA) is also contributing to part time employment problem, as employers are inclined to hire workers just under the 30 hour per week threshold that would

EMPLOYMENT

require them to provide health benefits. The new administration has vowed to repeal and replace the landmark legislation, but that could take years to make happen, if it ever does. Too much water may have flowed under that bridge already.

The Labor Participation Rate, the metric that measures the percentage of those eligible for employment between the ages of 16 and 64 who are currently working, also remains stagnant. Choppy job growth reports and the early exit of Baby Boomers, have combined to keep just 62.7% of potential workers in active production. It is important to note that Labor Participation has moved off a five decade low, but it may head down again in the next few years as the rate of early-retiring Baby Boomers increases.

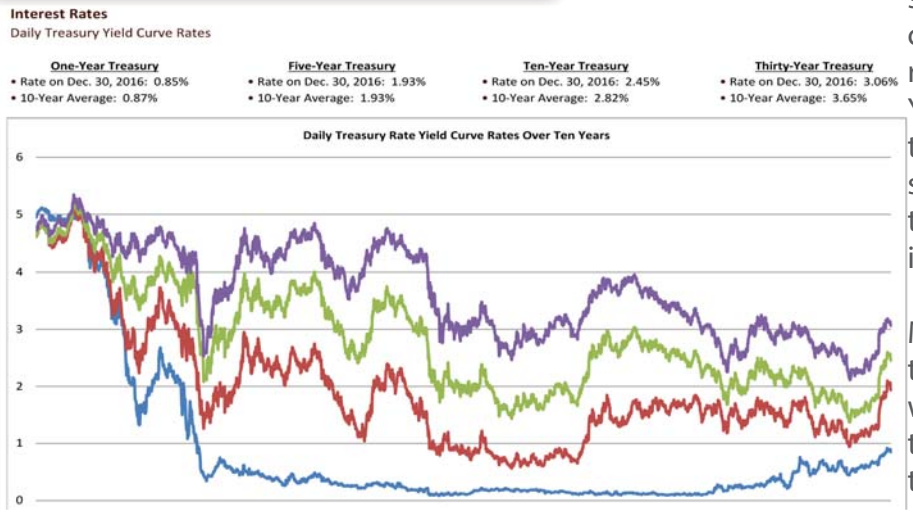
Lagging wage growth is another problem that has dogged the US economy in this recovery. Full-time, high-paying jobs are in short supply and wage growth overall is tracking at a rate that finally rose to 2.9% in December. If you are making a middle income wage, a 3% increase may not change your spending habits. Half of that increase will cover inflation, leaving the other half for discretionary spending. That kind of wage growth offers little relief to workers at or near the minimum wage level who are struggling to make ends meet. It's no wonder that so many middle class workers are disillusioned with a recovery that they feel has left them behind.

Layoffs in the energy sector have not helped the job picture, either. More than 700,000 full time positions have been eliminated since oil prices declined sharply back in 2014. Many of those jobs were high-paying technical positions that are not easily replaced in other business sectors like technology and business services that have contributed most to recent job gains.

MONETARY POLICY

After a year of sending cryptic mixed signals, the Fed finally stepped up in December and bumped up its benchmark Fed Funds Rate by another 25 basis points to .75%. By historical standards, that is still a very low number, and it will take a sustained series of quarter-point increases to reverse the activist stance of our central bank. Since the financial crisis that began at the tail end of 2007, the Fed has been heavily involved in manipulating the cost and flow of capital, more so than at any other time in its 100+ year history. Many have warned that the Fed has too much influence on the direction of the overall economy. Some believe our central bankers were caught off guard when their first move on rates roiled world markets and sent the US Dollar soaring back in January of 2016. A strong dollar makes US exports more expensive and raises the cost of paying back dollar-denominated loans for borrowers around the world. Simply put, the world threw an economic fit and central bankers around the globe pleaded with the Fed to forestall further increases until the global economy improved.

US TREASURY RATES
IN PERCENTAGE



It took several months for things to settle down, but Ms. Yellen and her colleagues were spooked away from raising rates for the rest of the year. Yield-chasers poured money back into the equity markets and the January slide turned into a bull run that was turbocharged by Trump's surprise win in November.

Meanwhile, central bank policy around the world has been going the other way. The European Central Bank has taken its benchmark rate into negative territory, as has the Bank of Japan. That means that borrowers get paid for borrowing money, which is counter-intuitive at a minimum. Both those central banks are buying corporate bonds in addition to their own sovereign debt, raising further concerns over the long term consequences of actions that are based on unproven economic models. The Bank of Japan is even buying individual stocks, an action that would be against the law for our Fed. Critics of central bank policy are calling out individual central bankers for doubling down on failed policies to save their academic reputations. That argument may just have some merit.

The good news about the most recent move by the Fed is that it gave itself a little room to work with if the economic recovery does stall. With GDP growth so weak in the first half of 2016, concern a possible recession was on the rise.

Fortunately, Q3 growth improved, but the first estimates for Q4 came in at a disappointing 1.9%. Hopefully, the Fed can follow through with further rate hikes in 2017 to move further out of the corner it painted itself in to over the past 10 years. If not, it could run out of ammunition to stimulate growth and be forced into the uncharted waters of negative interest rates.

MONETARY POLICY

Trump's promise of a massive infrastructure investment has buoyed hopes that the Federal government will help out on the fiscal side of the equation, and not continue to leave all the heavy lifting up to the Fed. But, that means bigger federal deficits that are already on their way back to over $1 Trillion per year. Bottom line: the Fed still has itself in a pickle and is short on ideas to get the economy back on a track of healthy growth. The takeaway might be that the Fed has reached the limits of its effectiveness, and that might get investors more focused on markets themselves rather than what impact Fed action will have on those markets. We'll just have to see if we are really open to learning that lesson.

Real estate borrowers are still the beneficiaries of the Fed's current monetary policy direction. Mortgage rates have remained at historic lows, but they have begun to move up. Most commercial property lenders use a spread over the yield on the 10 Year T-bill to set mortgage rates, and that yield has risen by over 50 basis points since the election. Long-term loans are still readily available, but underwriting is tightening up and interest rates have already moved higher. The Fed's willingness to make another move up in the short term will be a signal for long term lenders to get more aggressive with further rate hikes of their own. For the moment, it's still a good time to borrow money.

Nothing against Ms. Yellen and her Board of Governors, but it would sure be nice if they were off the front page every day.

GLOBAL ECONOMY

In the past two quarters we have been describing the global economic outlook as troublesome. We still do, but we can point to at least some improvement around the world. The panic over the Brexit vote was short-lived. It didn't take long for world markets to absorb the news. There's a long way to go, but the UK's exit from the EU is drawing much less attention now. The British Pound took a beating, but that may also be short-lived, once the actual process ramps up this spring.

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

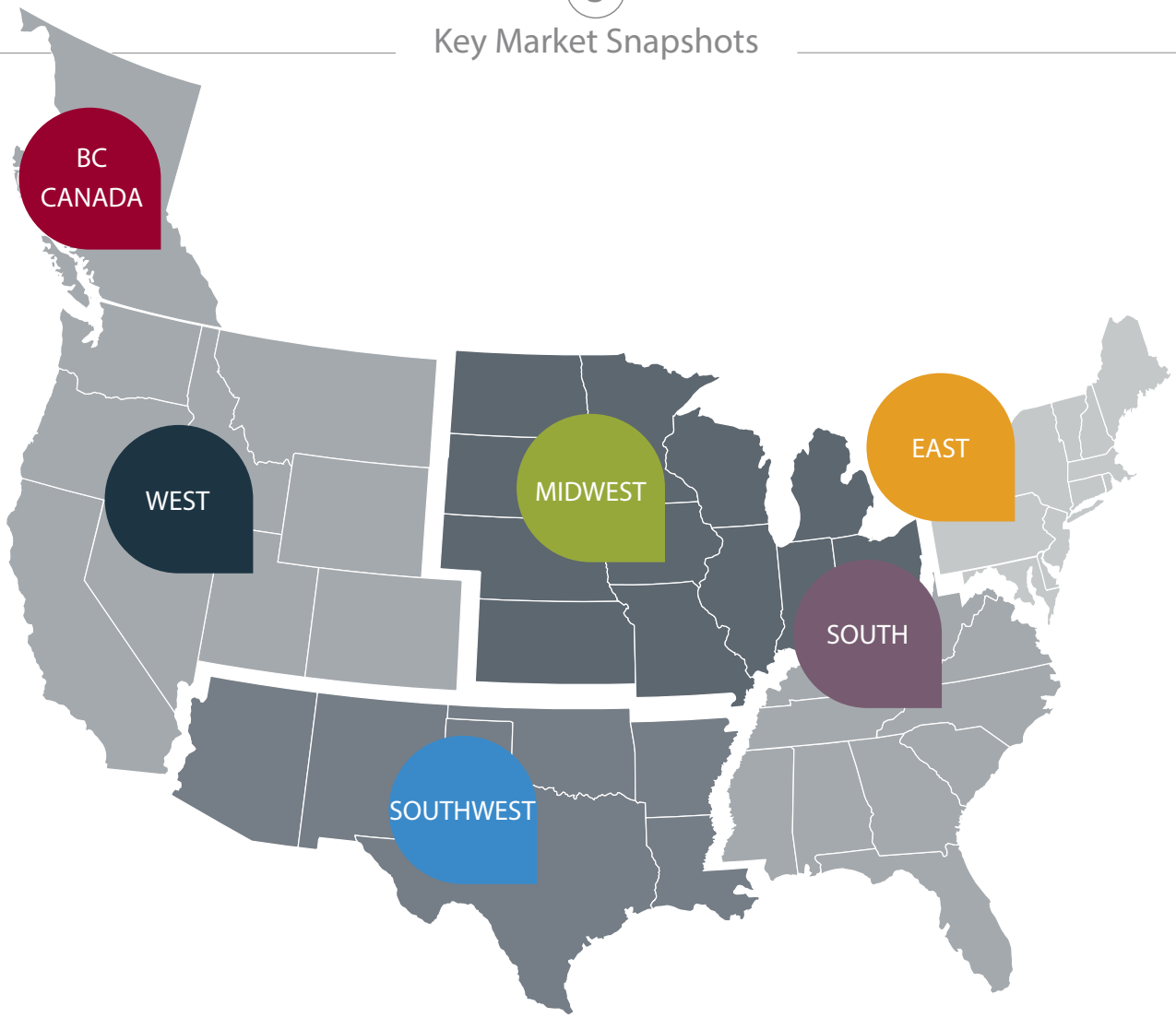
When the UK made its surprise decision, the long term survival of the EU became a major topic. Europe's political union is still in crisis mode and without a governing body with the real authority to enforce anything, it will likely remain so. Sovereign debts keep rising, unemployment is persistently high and GDP growth in Europe is nearing recession territory, despite the aggressive monetary policy of the European Central Bank. Calls for fiscal austerity have been largely ignored, and the ongoing refugee crisis has whipped up nationalist fervor throughout Europe. The Euro and British Pound have taken a beating.

Energy exporting nations are still hurting due to the sharp decline in oil prices, but the recent OPEC agreement to cap production has sent the price of a barrel of oil back above $50. Though, oil is transacted in dollars and the dollar strengthened against other currencies. So, the effect of the price gain may be partially offset. Non-OPEC producers like Russia and Venezuela have also shown a willingness to cap production in order to bring supply and demand into better balance. At the same time, US production looks to be ramping back up, as evidenced by an increase in rig count over the past several months. As the price of a barrel of oil goes up, more wells can turn a profit. For now, supplies are still running ahead of demand and recent agreements essentially cap production at current levels in the hope that an increase in demand from economic expansion over time will eventually absorb excess supply.

Oil-rich Middle-Eastern countries, including Saudi Arabia, are burning through cash reserves to cover revenue shortfalls precipitated by the falling price of oil. China is issuing sovereign bonds to help it cope with its massive transition from total dependence on the exportation of manufactured goods.

None of this sounds like good news and that is undeniably correct. However, the US economy is in much better shape relatively speaking. Once again, the world views the US as the safe haven of choice. That keeps capital moving into the US and much of that finds its way to the commercial real estate market. In fact, foreign demand for US real estate assets continues to contribute to gains in asset prices, as it increases competition in all product types. Foreign investors are willing to pay a premium to assure the preservation of their capital.

Key Market Snapshots



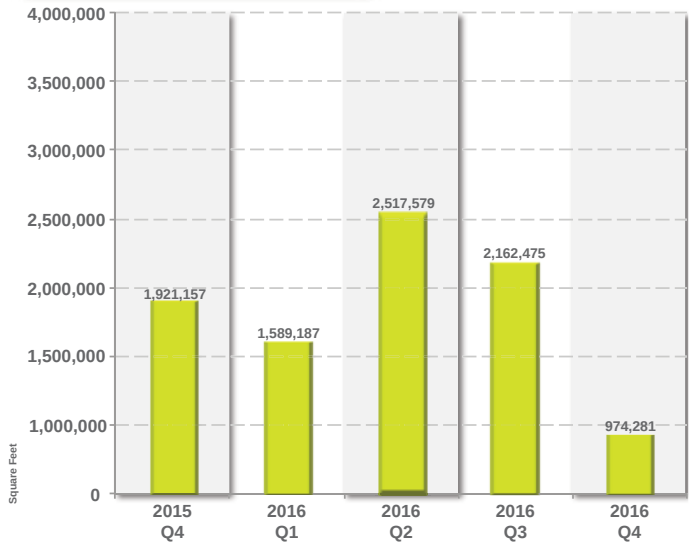
DALLAS/FT WORTH

ATLANTA
CHARLESTON

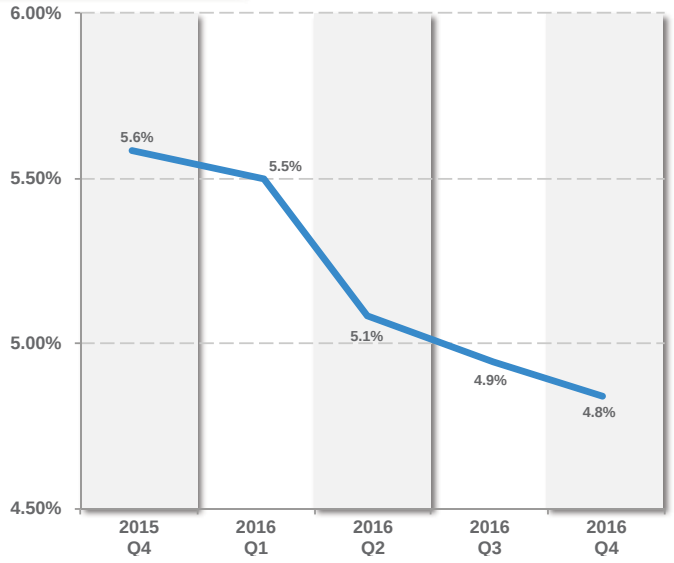
VANCOUVER BC, CANADA

DALLAS / FT WORTH

NET SF ABSORPTION



VACANCY RATE



TRENDING NOW

The Dallas/Fort Worth area (DFW) area remains a national leader in population and job growth. That has kept the DFW retail sector in growth mode. More jobs means more income for retail purchases. Demand for consumer services and products has been strong throughout the North Texas area, as the region has been less affected by lower oil and gas prices than more energy-dependent regions of the state. The area is also known for its predictable regulatory environment.

DFW's premier geographic location and unparalleled infrastructure makes it a major distribution hub and a place for larger companies to establish headquarters and maintain labor-intensive operations. Toyota, State Farm Insurance, JP Morgan Chase and other corporate users have come to the area to attract and retain the employees they need to grow their operations. Workers at all skill and education levels are moving to Texas to take advantage of the lower cost of living, vibrant housing market and Texas lifestyle. That has kept the retail market in expansion mode for the past several years.

Retail vacancy declined by another 10 basis points in Q4 to finish the year at just 4.8%. Year-over-year, the vacancy rate fell 60 basis points on a total base inventory over nearly 413 million square feet. Transactions contributing to that decline included the 140,167-square-foot lease to At Home on Midway Road and a 127,000-square-foot location for Walmart on Princeton Drive. Kroeger, the nation's largest grocery operator, moved into another 114, 792-square-foot store on Wilshire Blvd.

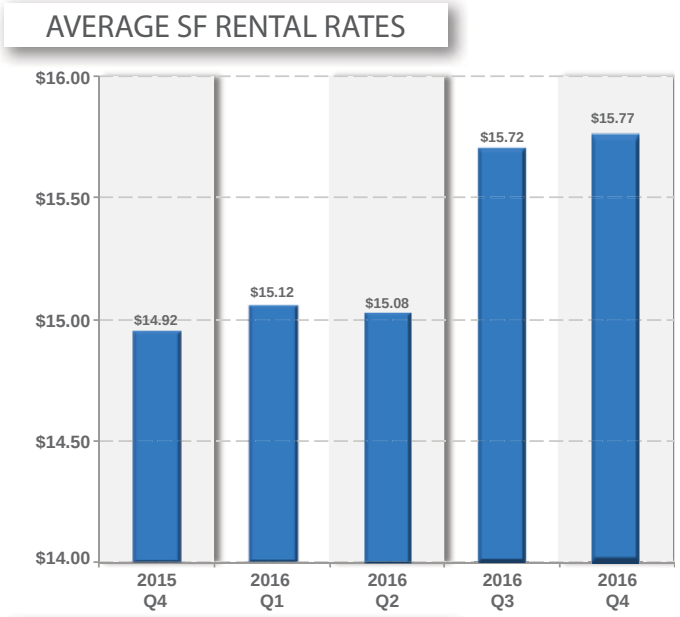
4.8%	$15.77	974,281	412,727,819	5,194,789
VACANCY	AVG. SF RENTAL RATES	NET SF ABSORPTION	RETAIL SF INVENTORY	SF UNDER CONSTRUCTION

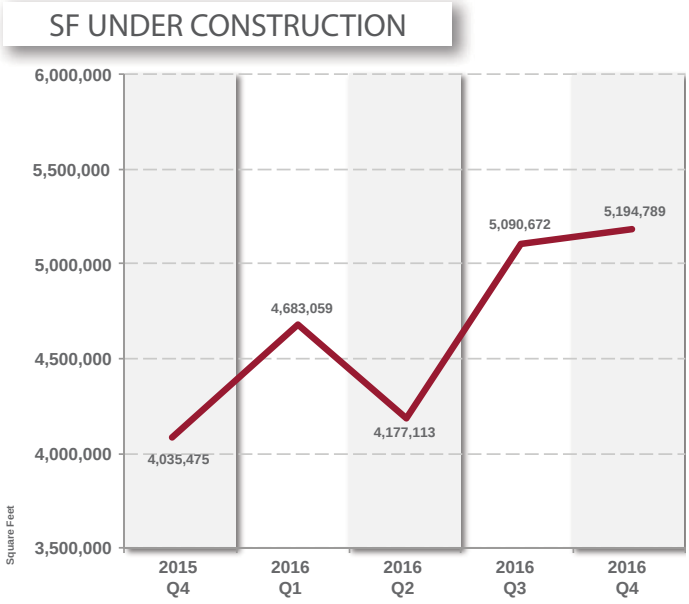
DALLAS / FT WORTH - TRENDING NOW (continued)

Net absorption remained firmly in positive territory throughout the year, but cooled off the final quarter to 974,000 square feet after five consecutive quarterly occupancy gains of more than 1.5 million square feet. Year-over-year, retail occupancy is up by over 7 million square feet.

The combined average asking lease rate for all retail categories in Q4 rose by $.05 to $15.77. Year-over-year, that rate increased by $.85 or 5.7%. Rents are rising faster in prime areas, forcing some tenants to opt for secondary locations. Power Centers continue to experience the highest rent levels with an asking rate of $31.81, but demand for big box locations is being impacted by the rise in online sales. Regional mall asking rents at the end of the year were $22.08, up $1.52 year-over-year, but down by $.33 in Q4. As in other major markets around the US, the best malls are performing well, but those in secondary locations anchored by traditional department stores are struggling.

New deliveries for the entire region in Q4 included 44 buildings totaling 625,738 square feet. In all of 2016, over 5.7 million square feet of new retail space was delivered, and another 5.2 million square feet of new space remained under construction as the year ended. Strong leasing activity has kept fears of overbuilding to a minimum but the ongoing expansion of online retailing poses a significant challenge to brick and mortar retailers, especially the major department stores.



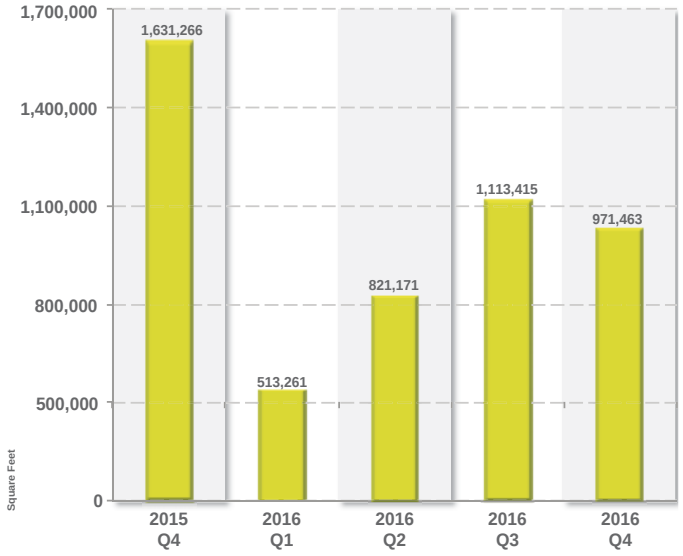


A LOOK AHEAD

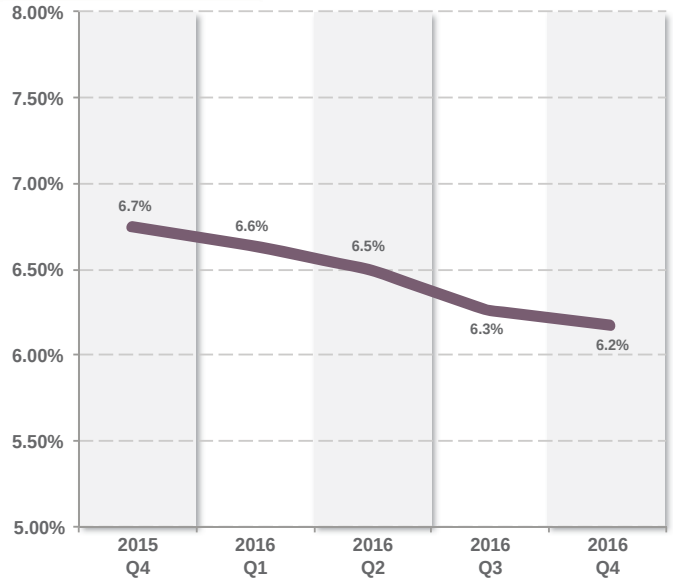
- Leasing activity will remain strong for the next 18 months
- Net absorption will stay in positive territory
- Vacancy should stay on its current trajectory
- Average asking lease rates will move another 2% to 3% higher this year
- Construction will increase, particularly in the Far North Dallas area
- More landlords will become sellers to 'strike while the iron is hot'
- Tenants will resist long term leases due to the threat of further competition from e-retailers

ATLANTA

NET SF ABSORPTION



VACANCY RATE



TRENDING NOW

Strong population and job growth throughout the Atlanta metro area kept the retail sector in expansion throughout the year. Urban core locations are still getting the most attention from retailers due to higher population density and demographic mix associated with the re-urbanization trend that has swept the nation. Mixed-use projects dominate the development scene, as they command the highest rents and maintain the most appeal to younger residents who prefer the walkable amenities associated with urban locales. Millennials, unlike their Baby Boomer counterparts tend to spend more on at trendy restaurants and entertainment venues rather than on houses and cars. Developers have responded by offering affordable Class A housing options for young professionals who choose to live inside the Perimeter.

As we reported last quarter, mixed-use projects like Krog Street Market, a renovated 1920's era warehouse, and the Ponce City Market, a complete renovation of the old Sears & Roebuck property, are thriving. Ground-up construction is still light, but over 2 million square feet of retail space was delivered to the Atlanta market in 2016, with 656,000 square feet of that total delivered in the final quarter. Another 3.5 million square feet is still underway.

Net absorption remained in positive territory in Q4, logging an increase in occupied space of 971,463 square feet, compared to 1,113,414 square feet in Q3 and 821,171 square feet back in Q2. The biggest move-ins for 2016 included the 172,000-square-foot lease to Van Mour in the Mall of Georgia and Kroeger's 119,653-square-foot lease at Main Street Marketplace. The overall vacancy rate fell by 10 basis points to 6.2% in Q4.

6.2%	$13.09	971,463	356,064,012	3,514,977
VACANCY	AVG. SF RENTAL RATES	NET SF ABSORPTION	RETAIL SF INVENTORY	SF UNDER CONSTRUCTION

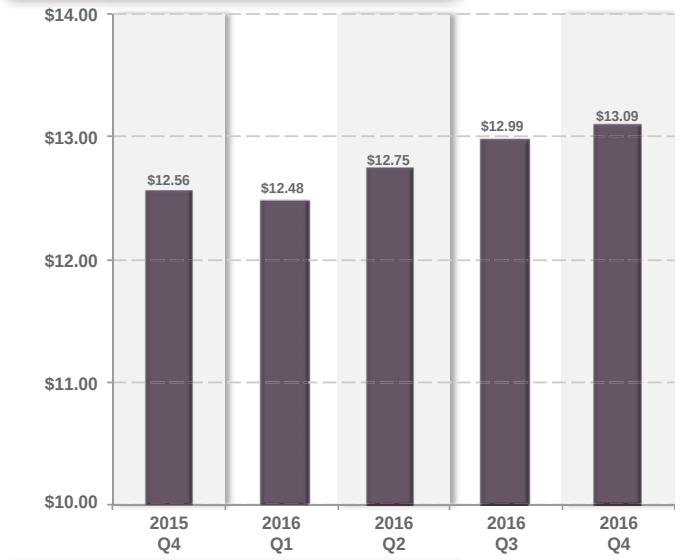
ATLANTA - TRENDING NOW (continued)

Asking rents still vary widely by submarket. Prime locations in urban locales command the highest rents, but quality space there is running in short supply. In Buckhead, the average asking rate is $28.26, but, the overall average asking lease rate for the Atlanta region at the end of the year stood at a more modest $13.09, up $.10 in the final quarter.

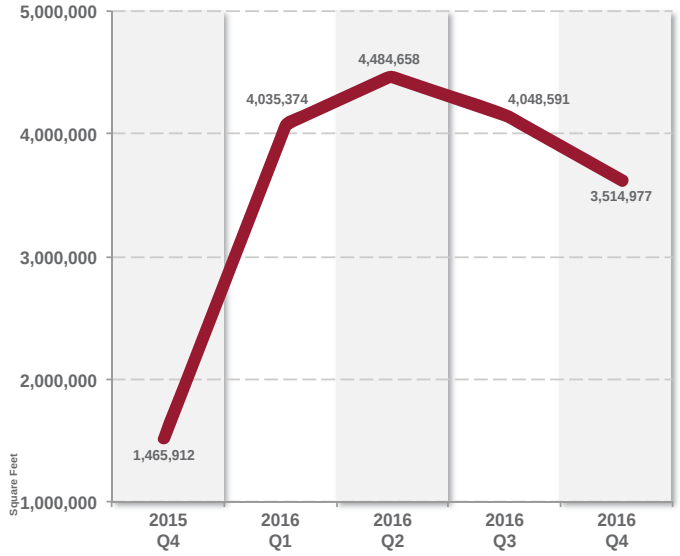
Suburban centers anchored by popular grocery retailers like Kroger, Publix and Whole Foods are also seeing strong demand and more rapid rent growth for shop space. Retailers in suburban areas are becoming more experiential, to help distinguish their local brands from others. Many tout their supply of local goods and services, including liquor stores, styling salons and boutique stores. As this trend has gathered momentum, secondary and tertiary locations are seeing a pick-up in demand. This is giving existing owners and add-value developers the confidence to make capital investments to enhance the appeal of their properties to fit the local culture and style of an area.

The popular indoor malls including Phipps Plaza and Lenox in Buckhead are performing well. However, consumers are showing strong interest in outdoor venues like Avalon, as well. In fact, construction of Avalon's second phase is underway and will include multifamily units along with major grocery retailers. Malls in secondary markets are faring worse, and are coming under increasing pressure from the growing popularity of mixed-use projects.

AVERAGE SF RENTAL RATES



SF UNDER CONSTRUCTION

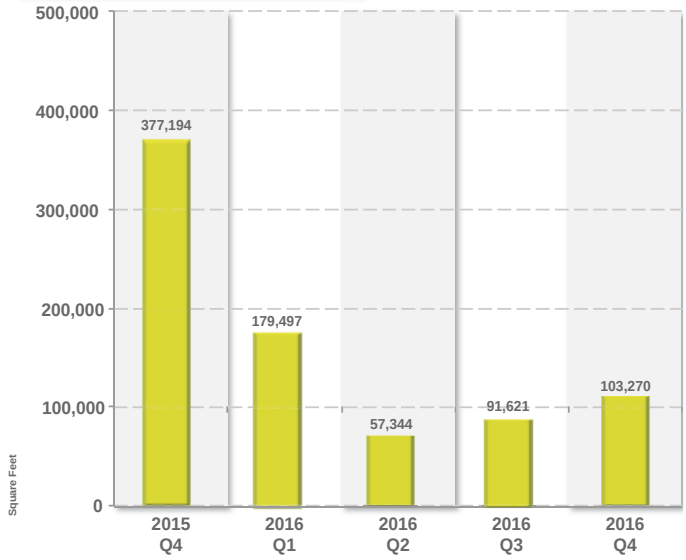


A LOOK AHEAD

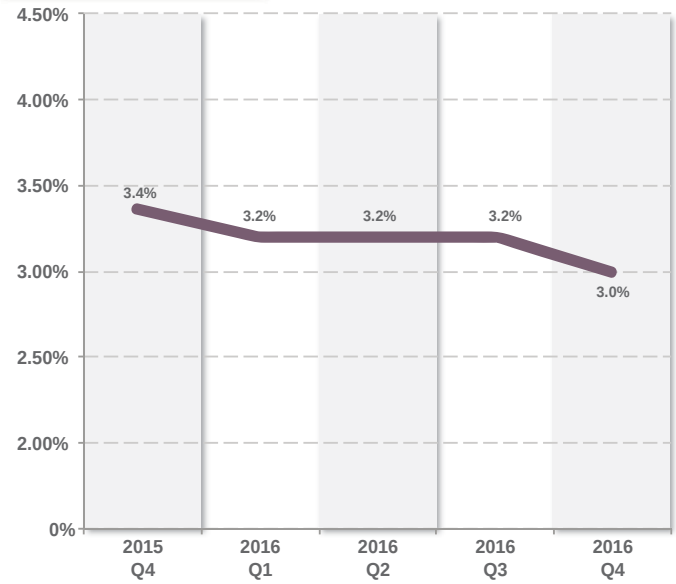
- Gross sale and lease activity will be strong through the first half of the year
- Net absorption should remain positive and steady
- Average asking lease rates may see a decline of up to 5% by the end of the year due to short supply of quality space in urban locales
- The overall vacancy will decline in the second half of the year
- The pace of ground-up retail and redevelopment projects will pick up in 2017
- Expect the experiential retail concept to gain popularity as a way of competing with online sales competition

CHARLESTON

NET SF ABSORPTION



VACANCY RATE



TRENDING NOW

Charleston is more than a picturesque town with scores of luxury and tourist-class hotels, award-winning restaurants and quality shopping. To be sure, tourism is a major contributor to economic activity, but the local economy is seeing record robust growth across the board and its population is growing by 48 people per day. The influx of manufacturing jobs generated by Boeing, Daimler, Volvo and others is generating jobs that fuel residential and retail growth. The South Carolina Ports Authority, which operates Charleston's two shipping terminals, are getting a $1.6-billion expansion to accommodate super freighters traversing the recently widened Panama Canal.

Vacancy fell 20 basis points in Q4 to 3.0% after holding at 3.2% for the previous three quarters. As a result of such limited inventory, landlords still have the advantage in terms of improvement allowances and other concessions. Tenants are finding it particularly tough to secure quality locations in Mount Pleasant, downtown Charleston and Summerville. Average asking rates rose $.64 in 2016, ending the year at $18.73.

Net absorption remained positive throughout the year, but slowed substantially compared to 2015. In Q4, a net gain occupied space of 103,270 square feet was recorded, bringing the total gain for 2016 up to 431,732 square feet compared to nearly 1.4 million square feet in 2015. Clearly, the lack of inventory is figuring into the absorption picture, as demand for good locations is still very strong.

It's still a good time for landlords to sell as cap rates remain low and the region is still attracting institutional capital looking for higher yields than are currently available in the

3.0%	$18.73	103,270	43,509,158	396,889
VACANCY	AVG. SF RENTAL RATES	NET SF ABSORPTION	RETAIL SF INVENTORY	SF UNDER CONSTRUCTION

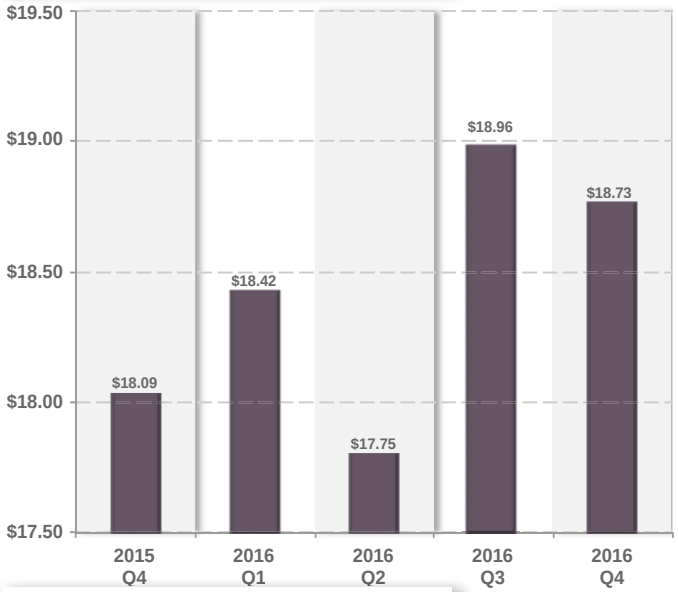
CHARLESTON - TRENDING NOW (continued)

largest markets. However, with the uptick in mortgage interest rates, cap rates have leveled off, and in some cases, increased. Further action by the Fed to tighten monetary policy could result in measurable cap rate decompression later in the year, as yields in alternate asset classes move higher. The yield on the 10 year US T-bill, a key benchmark, has risen over 100 basis points since March of 2016.

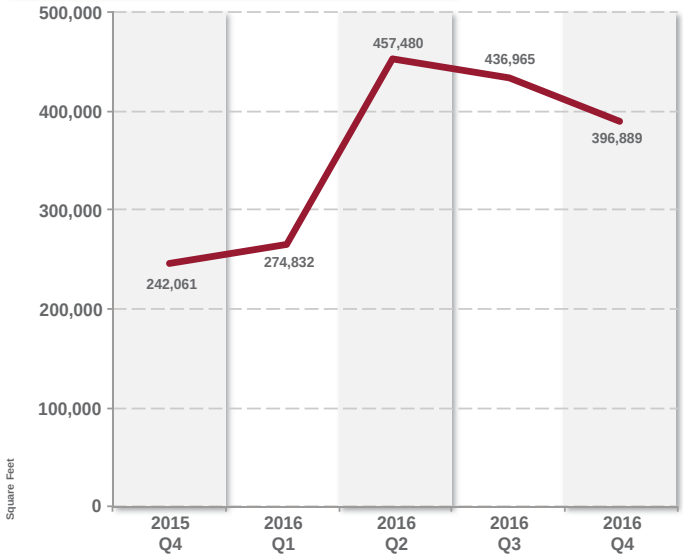
Demand for new retail property remains strong, but high land and construction cost, coupled with a protracted entitlement process, is making things difficult for developers. Deliveries were light in 2016, with just over 333,000 square feet of new space delivered, roughly half the total for 2015. Total inventory of retail space hit 43.5 million square feet by the end of the year and almost 400,000 square feet was in the construction queue.

As we reported last quarter, Charleston's new mayor, John Tecklenburg, is targeting the West Ashley submarket for more retail investment. Harris Teeter plans a second store in Westwood Plaza in 2017 and Whole Foods also has plans to expand into the area.

AVERAGE SF RENTAL RATES



SF UNDER CONSTRUCTION

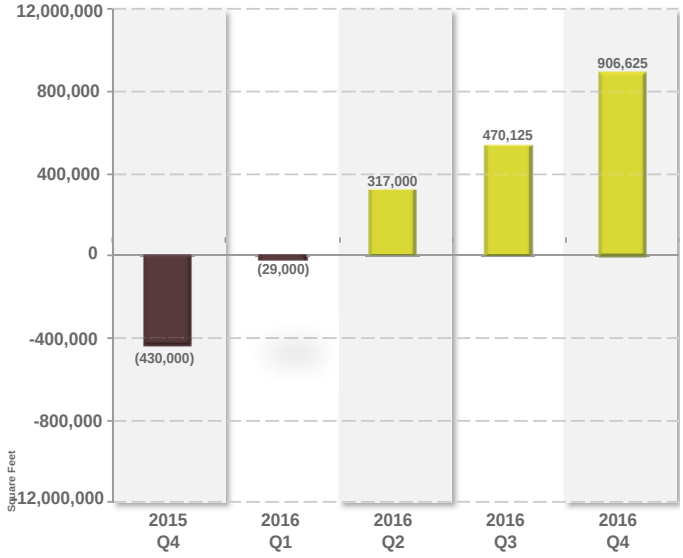


A LOOK AHEAD

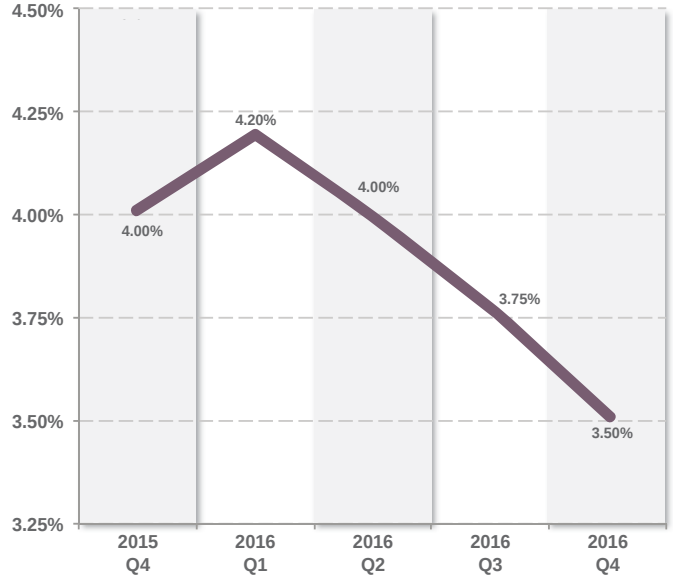
- Leasing activity will continue to outpace new deliveries
- Absorption will remain in positive territory, but will be limited by low supply
- Vacancy will move lower due to low levels of new construction
- Rental rates may level off as a rise in interest rates could dampen consumer spending
- Cap rates will rise as borrowing costs move higher
- Expect more mixed-use projects with ground-floor retail under multi-family or office space

VANCOUVER, BC CANADA

NET SF ABSORPTION



VACANCY RATE



TRENDING NOW

The Vancouver metro region boasts a highly diverse economic base that makes it the leading growth market in Canada. Port Metro Vancouver, Canada's largest port, moves over $130 Billion in goods from around the world and receives over one million cruise ship visitors each year. The region is also the headquarters for forest products and mining companies, a center for software development, biotechnology, aerospace, video game development and television/film production. With its location on the Pacific Rim and at the western terminus of Canada's transcontinental highway and rail routes, Vancouver is also one of the nation's largest industrial cities.

Retail sales in all of British Columbia topped $62 billion through the first 10 months of 2016, a 6.6% increase year-over-year. Strong retail sales growth is critical to expanding retailers and it contributes to job growth. The cost and availability of money in British Columbia remains favorable, which has kept interest in acquiring real estate of all kinds at a high level. The Bank of Canada kept its overnight right at .5% through the end of the year despite the December bump by the US Fed south of the border.

In 2016, numerous international retailers opened either their first Canadian or Western Canadian locations. That trend continues, as two global Japan-based retailers, Muji and Uniqlo, will be opening in Vancouver in 2017. Other big names like Nordstrom and Saks Off 5th, have plans for further expansion in the area, but supply of prime locations has run short, forcing them to move quickly as opportunities are identified.

Another developing trend is the proliferation of pop-up locations, primarily in the City of Vancouver. These temporary stores increase brand awareness, particularly for

3.5%	$34.00	906,625	16,150,000	1,100,000
VACANCY	AVG. SF RENTAL RATES	NET SF ABSORPTION	RETAIL SF INVENTORY	SF UNDER CONSTRUCTION

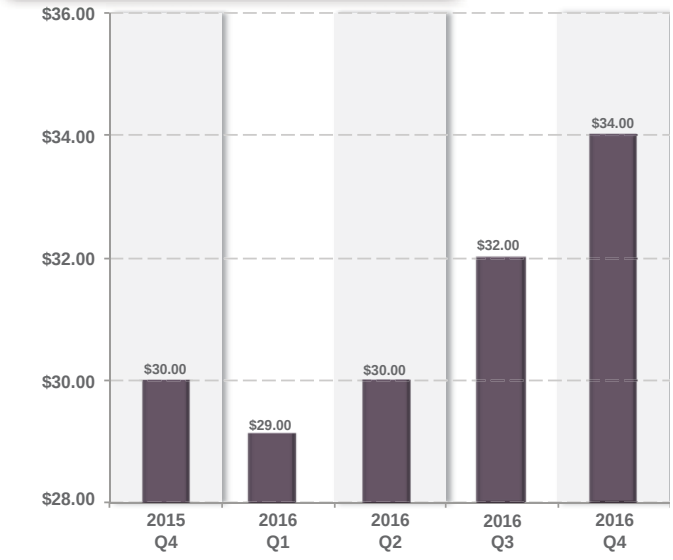
VANCOUVER, BC - TRENDING NOW (continued)

tenants new to the area. While Muji prepares its first permanent locations, a 10,000 SF location on Robson Street and an 8,000 SF location in Burnaby's Metrotown mall, it plans to open a pop-up in the high-profile Pacific Rim Hotel in downtown Vancouver.

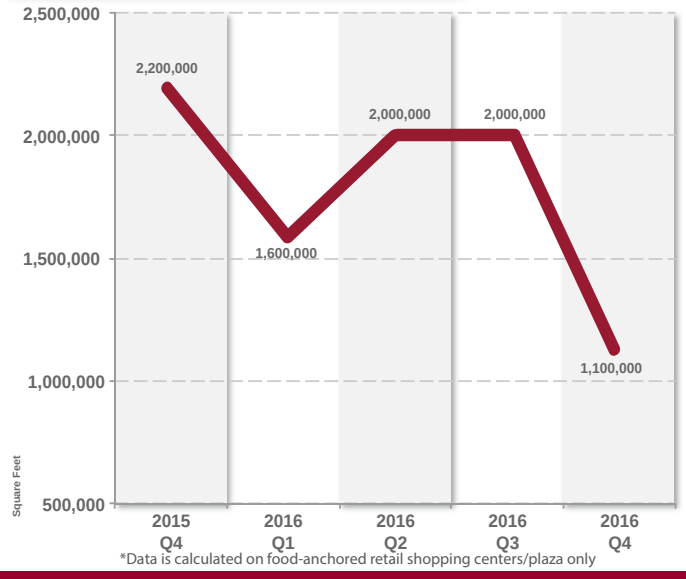
Regional malls in Vancouver, unlike many of their counterparts in the US, are faring well. According to a recent study by the Retail Council of Canada, the Metro Vancouver region has the highest average total sales productivity for malls in the country. CF Pacific Center and Oakridge Center, both in Vancouver, have seen an increase in activity from luxury retailers in particular. The recent expansion of Holt Renfrew and the 300,000-square-foot Nordstrom store at Pacific Centre, are top performers, proving the veracity of the luxury retail sector. In general, mall owners are increasing their investment in renovations, and pop-up locations are on the rise. Even online retailers are opening up brick and mortar locations in the region's malls.

The Vancouver market is looking quite healthy by the numbers, as well. Net absorption increased substantially in the last three quarters of 2016, after a nominal decline in Q1. On a base inventory of 16.1 million square feet of food-anchored centers, a net gain in occupied space of nearly 1.7 million square feet was recorded in 2016. The average asking rental rate rose $4 year-over-year to $34 and vacancy ended the year at just 3.5%, down 25 basis points in the final quarter. As the year ended, 1.1 million square feet remained in the construction queue.

AVERAGE SF RENTAL RATES



SF UNDER CONSTRUCTION



*Data is calculated on food-anchored retail shopping centers/plaza only

A LOOK AHEAD

- Construction is expected to increase over the next 24 months, particularly in mixed-use and master-planned community projects
- Net absorption will remain steady or move slightly higher as new mixed-use developments are completed
- Vacancy will continue to move lower, especially in the City of Vancouver, as construction there will not keep pace with demand
- Rental rates will move by as much as 10% during the year, especially in high-demand submarkets like Gastown, Vancouver
- Sales prices will continue to rise, most notably for properties with increased FAR due to neighborhood plan updates
- Foreign capital will continue to pour Vancouver in 2017

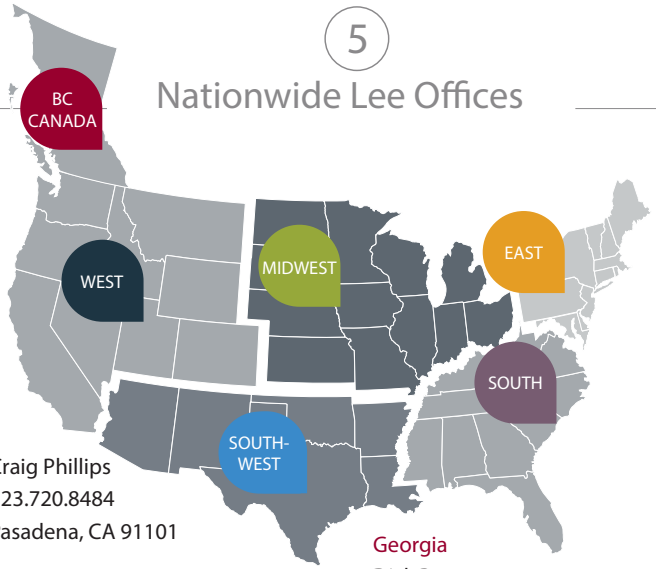
SELECT TOP RETAIL LEASES Q4 2016

BUILDING	MARKET	SF	TENANT NAME
609 E. Maple Ave	Richester	315,000	Virginia Conservation Legacy Fund, Inc.
Marketplace Design Center	Philadelphia	136,000	Aramark
6514-6550 Aaron Aronov Dr	Birmingham	110,000	Home Plus Storage
6700 Mack Rd	Sacramento	100,000	Furniture USA
The Village at Riverstone	Houston	100,000	Kroger
2051-2325 18 Mile Rd	Detroit	106,774	Kroger
4000 Venture Dr	Atlanta	98,667	Havertys Outlet
1 W. Flatiron Cir	Denver	97,241	Dick's Sporting Goods
Mesa Pavilions North	Phoenix	92,904	Floor & Decor

SELECT TOP RETAIL SALES Q4 2016

BUILDING	MARKET	SF	PRICE PSF	CAP RATE	BUYER	SELLER
Cabin John Shopping Center	Washington	214,204	$770.29	N/A	EDENS	Carl M. Freeman Companies
555 9th St	San Francisco	148,832	$944.69	N/A	Acadia Realty Trust	SPI Holdings
155 Mercer St	New York City	16,500	$5,636.36	N/A	ASB Capital Management	Thor Properties
Aspen Grove	Denver	267,477	$306.57	6.2%	Gerrity Atlantic Retail Partners, LLC	DDR Corp
The Village at Fairview	Dallas/Ft Worth	576,051	$119.78	N/A	Lincoln Property Co	Prudential Real Estate
Danada Square East	Chicago	198,880	$318.03	4.86%	LaSalle Investment Management	Newport Capital Partners, LLC

Nationwide Lee Offices



Arizona
Fred Darche
602.956.7777
Phoenix, AZ 85018

California
Clarice Clarke
805.898.4362
Santa Barbara, CA 93101
(Central Coast)

Brian Ward
760.346.2521
Palm Desert, CA 92260
(Greater Palm Springs)

John Hall
949.727.1200
Irvine, CA 92618

Mike Tingus
818.223.4380
LA North/Ventura, CA 91302

Craig Phillips
323.720.8484
Commerce, CA 90040
(LA Central)

Robert Leveen
213.623.1305
Los Angeles, CA 90071
(LA ISG)

Greg Gill
562.354.2500
Long Beach, CA 90815
(Los Angeles)

Aleks Trifunovic
310.899.2700
Santa Monica, CA 90404
(LA West)

Steve Jehorek
949.724.1000
Newport Beach, CA 92660

Craig Phillips
562.699.7500
City Of Industry, CA 91746

Craig Hagglund
510.903.7611
Oakland, CA 94607

Don Kazanjian
909.989.7771
Ontario, CA 91764

Bob Sattler
714.564.7166
Orange, CA 92865

Craig Phillips
323.720.8484
Pasadena, CA 91101

Mike Furay
925.737.4140
Pleasanton, CA 94588

Dave Illsley
951.276.3626
Riverside, CA 92507

Dave Howard
760.929.9700
Carlsbad, CA 92008
(San Diego North)

Steve Malley
858.642.2354
San Diego, CA 92121
(San Diego UTC)

Tom Davis
209.983.1111
Stockton, CA 95206

Dave Illsley
951.276.3626
Murrieta, CA 92562
(Temecula Valley)

Don Brown
760.241.5211
Victorville, CA 92392

Mike Furay
925.369-0309
Walnut Creek, CA 94596

Denver
John Bitzer
303.296.8770
Denver, CO 80202

Florida
Jerry Messonnier
239.210.7610
Ft. Myers, FL 33966 (Naples)

Tom McFadden
321.281.8501
Orlando, FL 32839

Georgia
Dick Bryant
404.442.2810
Atlanta, GA 30326

Victor Segrest
404.781.2140
Atlanta, GA 30328 (Appraisal)

Idaho
Matt Mahoney
208.343.2300
Boise, ID 83703

Illinois
James Planey
773.355.3014
Rosemont, IL 60018 (Chicago)

Indiana
Scot Courtney
317.218.1038
Indianapolis, IN 46240

Maryland
J. Allan Riorda
443.741.4040
Columbia, MD 21046

Michigan
Jon Savoy
248.351.3500
Southfield, MI 48034

Minnesota
Chris Garcia
952.955.4400
Minneapolis, MN 55401

Missouri
Thomas Homco
314.400.4003
St. Louis, MO 63114

Nevada
Lyle Chamberlain
775.851.5300
Reno, NV 89501

New Jersey
Rick Marchiso
973.475.7055
Elmwood Park, NJ 07407

New York
Jim Wacht
212.776.1202
New York, NY 10022

Ohio
Brad Coven
216.282.0101
Pepper Pike, OH 44124
(Cleveland)

Tim Kelton
614.923.3300
Dublin, OH 43017
(Columbus)

Pennsylvania
John Van Buskirk
717.695.3840
Camp Hill, PA 17011

South Carolina
Bob Nuttall
843.747.1200
Charleston, SC 29492

Randall Bentley
864.704.1040
Greenville, SC 29601

Texas
Trey Fricke
972.934.4000
Addison, TX 75001
(Dallas/Fort Worth)

Chris Lewis
713.660.1160
Houston, TX 77027

Washington
Jim Bowles
206.773.2673
Seattle, WA 98101

Wisconsin
Todd Waller
608.327.4000
Madison, WI 53713

BC Canada
Chris Anderson
604.684.7117
Vancouver, British Columbia

Gerald Eve
James Southey
+44 (0) 20 7333 6226
www.geraldeve.com

The Lee Retail Brief

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