Retail First Glance

2018
Quarter 2

Pre-Release Analysis of Second Quarter 2018 Reis Findings in the Retail Sector

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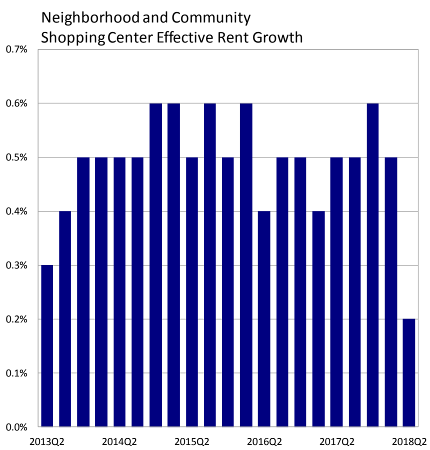
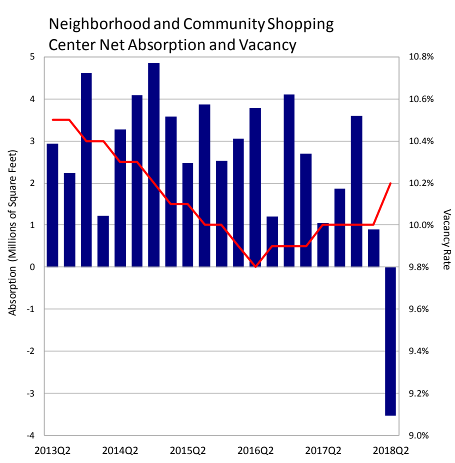
New York — July 16, 2018

Steady as She Blows

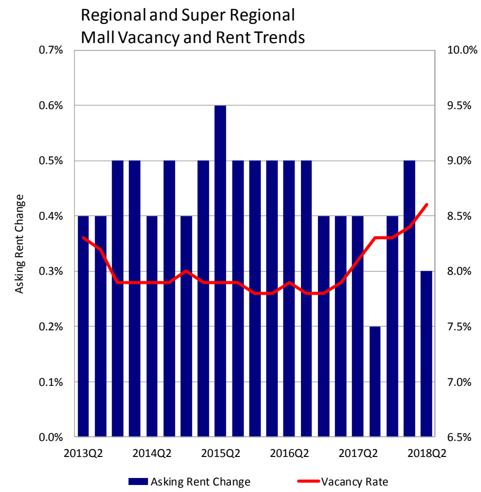


After withstanding the impact from store closures for nearly six quarters, the neighborhood and community shopping sector incurred negative net absorption of 3.5 million SF that pushed vacancy up to 10.2% from 10.0% in the first quarter. This was largely due to the Toys “R” Us closings, but a few others – Winn Dixie, Kmart, Bon-Ton, Bi-Lo and Harvey’s – closed in the quarter as well. The chart below shows how sharply this quarter’s numbers contrast previous quarters when occupancy growth was slow but positive nonetheless. The negative net absorption was spread widely, as 58 of 80 metros (73%) saw negative net absorption.

The mall vacancy rate increased to 8.6% in the quarter, up 20 basis points from 8.4% in the first quarter. A year ago, the vacancy rate was 8.1% when it had started to grow from a low of 7.8% in 2016. The average mall asking rent increased 0.3%, down from growth of 0.5% last quarter. This masks a continued gap between the higher-end malls, which are thriving, and the increasingly vacant lower-end malls. In a number of malls, the anchor department store – Macy’s or Sears – was likely owner occupied. These owner-occupied department stores do not factor into the overall vacancy or rent statistics for those malls.



New construction in neighborhood and community shopping center space was 1.08 million SF, the lowest since before 2010 and just over one quarter of the construction level in the second quarter of 2017, 4.0 million square feet. Completions totaled 1.34 million SF in the first quarter of the year. Although there is more construction expected this year, the level of new completions in the pipeline is much lower than in previous cycles and lower than in previous quarters this cycle.



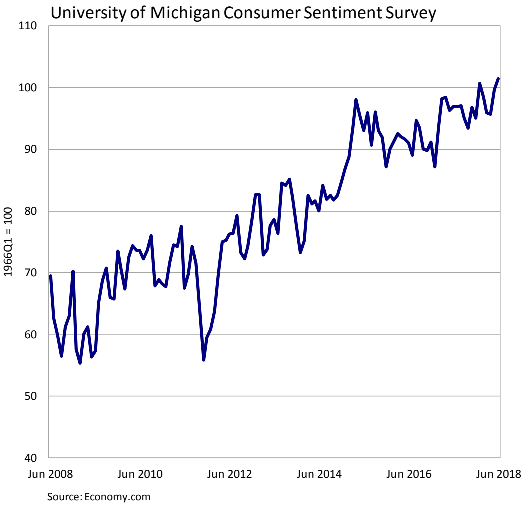
After averaging positive net absorption of 2.3 million SF per quarter in 2017, net absorption fell to negative 3.6 million SF in the second quarter. Net absorption in the first quarter was positive 900,000 SF. This quarter’s result could prove to be temporary, or it could be the start of a short-term trend of continued negative net absorption as the status of a few more Toys “R” Us stores has yet to be determined. That said, many non-traditional retailers have expressed interest in some of the many closed stores. These include entertainment outfits such as trampoline parks as well as self-storage operators. These new users could lease the empty space as early as this year.

Second Quarter 2018 Market Performance
Improving Fundamentals / Flat or Declining Fundamentals

	Absorption		Occupancy		Effective Rent	
Q2 2018	22 +	58	12 ↑	68	55 ↑	25
Q1 2018	43 +	37	29 ↑	51	66 ↑	14
Q4 2017	58 +	22	44 ↑	36	57 ↑	23
Q3 2017	46 +	34	32 ↑	48	64 ↑	16
Q2 2017	41 +	39	19 ↑	61	60 ↑	20

Figures are based on 80 metro markets.

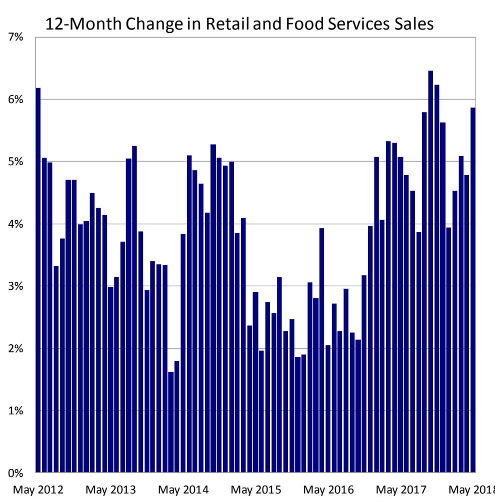
The average asking rent increased 0.3% in the second quarter following rent growth of 0.4% in the first quarter. The average effective rent growth was 0.2% in the quarter. As low as these were, it is surprising that rent growth was positive at all. This suggests that landlords remain somewhat optimistic that the momentum in the overall economy will drive future tenants to these empty stores. At $21.02 per square foot (market) and $18.39 per square foot (effective), the average rents have both increased 1.8% since the second quarter of 2017.



As referenced above, the number of metros that had a saw an increase in vacancy in the quarter increased to 57 from 35 in the prior quarter. This was mainly due to negative net absorption. Metros with the largest increase in vacancy include Little Rock, Fairfield County, Long Island, Columbia, Wichita and Central NJ – all of which had a vacancy rate increase of 0.8% to 1.4%. Metros with the biggest drop in vacancy include Syracuse, San Antonio, Nashville, Tacoma and Lexington. These metros saw vacancy rates drop by 30 to 90 basis points.

Not surprisingly, the number of metros that posted a rent decline in the quarter, increased to 25 from 13 in the previous quarter. Metros with the sharpest effective rent decline include Knoxville, Jacksonville, San Diego, Columbia and Tampa-St. Pete which had rent declines of 0.4% to 0.5%. The metros with the highest rent growth were Tacoma, San Francisco, Miami, San Jose and Providence that each had rent growth ranging from 0.9% to 1.4%. For the year, only six metros show a rent decline –down from seven last quarter – including Albuquerque, Wichita, Oklahoma City, Greenville, New Orleans and Tulsa. Metros that saw the strongest rent growth in the year were Miami, Seattle, Palm Beach, Salt Lake City and Orlando.

Metro employment numbers show a similar pattern to the net absorption numbers. For the quarter, the retail sector added 30,100 jobs in the quarter, 7,000 of which were in non-store retailers or e-commerce. Removing added e-commerce, auto and gas station jobs, the net retail sector added 18,400 jobs in the quarter but it has lost 2,200 jobs since the first half of 2017. However, restaurants added another 37,800 jobs in the quarter and has added 46,600 jobs since the first half of 2017.



The metro retail employment statistics mirror the occupancy statistics somewhat in that those that have added the most retail jobs in 2018 include Louisville, Jacksonville, Tacoma, Dayton and Seattle – although the Seattle jobs could be Amazon e-commerce related jobs. Metros with the biggest declines in retail jobs include Wichita, Knoxville, Chicago, Fairfield County and New Orleans. All totaled, 31 metros show a year-over-year decline in retail jobs, but many of these have gains in restaurant jobs.

Outlook

The Toys "R" Us store closings impacted the second quarter statistics more than any other retailer has in any quarter over the last nine years. In the Reis property inventory, we tracked more than 70+ total Toys "R" Us store closings in 40+ different metros in the quarter. Moreover, other retailers continued to shut down operations in the quarter including Winn-Dixie, Kmart and Harvey. Very few metros saw significant positive net absorption, but a few gyms and trampoline parks opened in some metros along with TJ Maxx, Target, Aldi's, Gabe's and Bob Mills.

That said, we believe most of the Toys "R" Us stores are now closed and that most of the negative net absorption is behind us. Although we do not expect the vacancy rate to improve in the near future, it will not increase that much more in the coming quarters.

Oddly, rent growth has remained positive despite the higher vacancy. We suspect that rents will stay flat for some time. Finally, we have a few new construction projects in the pipeline, but have seen a number of older and obsolete shopping centers sold as development sites. We expect any new completions will be few and far between and could get offset by conversions or demolitions.