Retail Outlook

Strong consumer confidence signals a positive year for retail sales, but fundamentals soften for most retail property types
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U.S. retail markets show signs of a slowdown

<table>
<thead>
<tr>
<th>Type</th>
<th>Total s.f.</th>
<th>Total Vacancy</th>
<th>YTD Net Absorption</th>
<th>Q1 2018 Avg rent</th>
<th>QOQ% Chg</th>
<th>YOY% Chg</th>
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</thead>
<tbody>
<tr>
<td>General Retail</td>
<td>5,726,884,042</td>
<td>2.9%</td>
<td>5,424,588</td>
<td>$19.88</td>
<td>2.8%</td>
<td>9.4%</td>
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<tr>
<td>Malls</td>
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<td>3.7%</td>
<td>1,224,516</td>
<td>$19.30</td>
<td>5.9%</td>
<td>-3.5%</td>
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<tr>
<td>Power Centers</td>
<td>799,003,820</td>
<td>4.5%</td>
<td>1,688,065</td>
<td>$17.66</td>
<td>-0.8%</td>
<td>-0.9%</td>
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<tr>
<td>Shopping Centers</td>
<td>3,695,166,705</td>
<td>7.3%</td>
<td>4,944,974</td>
<td>$15.52</td>
<td>0.6%</td>
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<td>Specialty Centers</td>
<td>90,061,209</td>
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<td>91,396</td>
<td>$14.90</td>
<td>-0.6%</td>
<td>-4.9%</td>
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<tr>
<td>Total Retail</td>
<td>11,240,824,780</td>
<td>4.6%</td>
<td>13,373,539</td>
<td>$17.21</td>
<td>1.7%</td>
<td>5.7%</td>
</tr>
</tbody>
</table>

Retail subtype | Definition | Examples |
--- | --- | --- |
General Retail | Consists of single-tenant, freestanding, general-purpose commercial buildings with parking | Drugstores, some groceries, street-front urban retail stores |
Malls | Includes Lifestyle Centers, Regional Malls and Super-regional Malls | Primarily anchored by mass merchants, fashion and department stores |
Power Centers | Consists of several freestanding anchors with minimal small tenants, 250,000–600,000 s.f. | Primarily anchored by big-box tenants and discount supercenters |
Shopping Centers | Includes Community Centers, Neighborhood Centers and Strip Centers | Primarily anchored by groceries and local services |
Specialty Centers | Consists of the combined retail center types of Airport Retail, Outlet Center and Theme/Festival Center | Primarily anchored by manufacturers’ and retailers’ outlets |
Total Retail | All retail building types in both single-tenant and multi-tenant buildings, including owner-occupied buildings | All retail |

Reading the clock

The JLL retail property clock demonstrates where each market sits within its real estate cycle. Markets generally move clockwise around the clock, with markets on the left side of the clock generally landlord-favorable and markets on the right side generally tenant-favorable. Many of the major metros, including Philadelphia, Boston and Los Angeles, have moved to a falling market as rent increases have softened and vacancies have plateaued or have risen.

Source: CoStar, JLL
After a slow start to 2018, retail sales improved as the quarter closed. March saw U.S. retail sales increase 0.8 percent from the previous month and they increased again by 0.3 percent in April. Consumer spending has been strong and should remain that way thanks to recent federal tax cuts and a healthy labor market.

**Pace of demand slows but is still positive**
Rents increased by 1.7 percent quarter-over-quarter and have reached pre-recession levels of $17.21 per square foot. Vacancy fell by 0.2 percent quarter-over-quarter, but that compression rate is slowing and it is likely that the U.S. will see vacancy rise in 2018.

Demand has been helped by limited supply as retail construction remains restricted—only 14.2 million square feet delivered in the first quarter. New deliveries have been focused on general retail, with less than one-third of new construction occurring in the shopping center and mall space. 66.1 percent of the square footage under construction is found in general retail projects, with the majority in New York City, Houston and Dallas.

**Markets benefit from population influx**
Major markets in Florida and Texas are seeing improving fundamentals in part because both states have seen strong population growth over the past year. Orlando and Miami have seen an influx of residents after Hurricane Maria hit Puerto Rico last fall and the heightened demand has helped support the local retail market. Contributing to the health of South Florida retail is the new higher-speed rail system that connects the two cities and the recent development around their stations. MiamiCentral, the southern terminus of the new rail system, includes a new food hall, Central Fare, in addition to significant new retail space in the heart of downtown Miami.

As of the first quarter, Houston and Dallas have the highest overall under-construction numbers across the country, with 3.2 million square feet in the pipeline in Houston and 3.0 million square feet in Dallas. Food and beverage has seen a surge in Houston as both new and established fast casual offerings are executing expansion plans across the metro. Texas also saw sustained growth from the grocery sector, which should continue into 2018, especially as H-E-B has announced six new locations for the year.

**Capital markets transactions decline**
Though transaction momentum continued to slow in the first quarter, retail investors are beginning to regain confidence. Retail transactions declined 30.9 percent quarter-over-quarter but renewed institutional interest hints at a promising back half of the year.

Most asset types continue to see transaction volume declines. However, power center volume remained stable with heightened investor attention despite increased vacancy and lagging inline sales in certain markets. Aside from best-in-class assets, cap rates continue to soften, with the market less willing to compromise on pricing.
Strong retail spending to continue in 2018
After a favorable holiday season, retail sales fluctuated but rebounded in March and April. Headline retail sales jumped by a stronger-than-expected growth rate while core retail sales also bounced back after some recent softness. Tax cuts along with income gains likely supported consumer spending. Healthy spending should continue in the second and third quarters of this year due to the same factors and should boost GDP.

Rising energy prices could slow retail sales but should not derail the U.S. consumer, which will contribute to the economic growth rebound from an expected lull in the first quarter.

Toys “R” Us tops the closures list—but it’s not all bad news
Despite strong economic indicators, closures are still rocking 2018. Most notably is the announcement that Toys “R” Us will shutter all 735 stores across the U.S. including Babies “R” Us locations. Toys “R” Us has a significant footprint across the country, and the closures of both Toys “R” Us and Babies “R” Us will impact retail fundamentals as stores begin to close in the second and third quarters of this year.

Walgreens also announced the closure of 600 stores as a result of the retailer consolidating surplus store locations after purchasing a portion of Rite Aid’s assets in 2017.

However, it’s not all bad news. Many of those vacant spaces left by underperforming retailers are being backfilled by off-price retailers, craft and hobby stores, and fitness centers. Gander Outdoors, formerly known Gander Mountain, which went bankrupt last year, has found new life in 2018 and plans to open nearly 70 locations this year.

The grocery industry continues to see steady growth as many grocers have announced aggressive expansion plans for the year. Aldi has announced 200 new stores for 2018, Lidl, while scaling back from its ambitious 2017 plans, will open 20, and Grocery Outlet will be working on expanding its footprint with approximately 25 new stores.

Best Buy will open its first store in seven years in the Salt Lake City metro area. This comes after the retailer announced the closure of all 257 mobile standalone stores. Best Buy found them less profitable and that they could offer a better experience in their large-format stores.

Off-price retailers have announced most openings and apparel remains the sector hardest hit by closures.

<table>
<thead>
<tr>
<th>Category</th>
<th># of Announced Openings</th>
<th># of Announced Closings</th>
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</thead>
<tbody>
<tr>
<td>Entertainment</td>
<td>15</td>
<td></td>
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<tr>
<td>Wholesale clubs</td>
<td>16</td>
<td>66</td>
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<tr>
<td>Discount dept. stores</td>
<td>35</td>
<td>379</td>
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<tr>
<td>Accessories</td>
<td>36</td>
<td>313</td>
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<tr>
<td>Shoe stores</td>
<td>52</td>
<td></td>
</tr>
<tr>
<td>Crafts/Hobby</td>
<td>60</td>
<td></td>
</tr>
<tr>
<td>Pet supplies</td>
<td>70</td>
<td></td>
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<tr>
<td>Specialty stores</td>
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<td></td>
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<tr>
<td>Health &amp; beauty</td>
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<td></td>
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<tr>
<td>Sporting goods</td>
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<td>Mass merchandiser</td>
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<td>Auto parts</td>
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<td>Grocery</td>
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<td></td>
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<tr>
<td>Apparel</td>
<td>663</td>
<td>600</td>
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<tr>
<td>Restaurants</td>
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<td>740</td>
</tr>
<tr>
<td>Discount/variety</td>
<td>1650</td>
<td>855</td>
</tr>
</tbody>
</table>

Source: PNC, Creditintell, JLL
Mall fundamentals impacted by late cycle

11 major markets have passed midnight on the mall property clock and are seeing softening rents, rising vacancies, and decreases in absorption over previous quarters. Malls in major markets are still achieving higher rents and have lower vacancies than the U.S. average but are not immune to effects of a late cycle.
Malls see softening fundamentals but move-ins continue to outpace move-outs
Major markets are still showing stronger fundamentals when compared to the U.S. average, but even markets with top-tier mall product are seeing impacts of a peaking cycle. In major markets, vacancies have remained steady for the past three quarters and are at 3.1 percent on average at the close of Q1. U.S. rents continue to fluctuate and remain below pre-recession peak at $19.30 per square foot.

Despite the closure headlines, mall move-ins have continued to outpace mall move-outs. However, that spread has thinned during the first quarter. Department store Bon-Ton recently announced that it will be closing all 256 stores, impacting malls primarily in the Midwest.

On the opposite end of the spectrum, Macy’s had a healthy first quarter and saw net sales of $5.5 billion, a 3.6 percent increase since last year. The company has been rightsizing its portfolio and has made $24.0 million in gains on real estate sales. Macy’s also recently acquired Story, a concept store currently located in Manhattan, signaling its commitment to brand experience.

Owners get creative to backfill vacant space
Mall owners continue to experiment with atypical tenants to fill spaces that have been left by underperforming retailers. The Glendale Galleria in Glendale, CA, owned by GGP, brought in the virtual reality concept The Void as an inline tenant this quarter. The Void is an immersive VR experience and this specific location is a Star Wars–themed attraction, adding to the appeal of the center and bringing in visitors who may not have normally made a trip to this location otherwise.

Mall owners are also adding in coworking spaces to attract new users. Cowork at the Mall, a Washington DC–based startup, is opening at Water Tower Place in Chicago, and will offer retail space for entrepreneurs and makers and testing areas for new products. Cowork at the Mall will take over a 15,000-square-foot space that was most recently occupied by Sports Authority.

Besides filling vacant space and bringing workers with wallets to malls, coworking spaces that are also retail incubators add value to malls by providing the kind of fun and new experience shoppers crave.

Mall partnerships give a positive outlook for the sector
Two major pending mergers, Unibail-Rodamco’s acquisition of Westfield and Brookfield’s acquisition of GGP, represent significant consolidation in the mall sector. As shopping center operators continue to transform their properties with improvements to both the physical space and the tenant mix, specifically evidenced by Westfield’s investment in its centers like Century City in Los Angeles, investors may see the future value of these assets. Malls’ shift to more experiential retail has positive implications for the sector and investors may have renewed interest.

Mall move-ins continue to outpace move-outs

![Graph showing mall space vacated, absorbed, and move-ins and move-outs](image)

New supply outpaces absorption in Q1

![Graph showing net absorption, total deliveries, and asking rent](image)

Source: CoStar, JLL
A shift in power center fundamentals is on the horizon

Several major markets have passed midnight on the power center property clock and have seen a shift in performance of fundamentals. With the Toys “R” Us bankruptcy announcement, power centers across the U.S. should see rising vacancies before the end of 2018.
Power center vacancy continues to decline but for how much longer?
The biggest news of the quarter for power centers was the announcement that Toys “R” Us will shut or sell all of its 735 stores. Toys “R” Us was crippled with debt and failed to make a full year of profit since 2012. This will leave approximately 29.0 million square feet vacant and will undoubtedly impact power center fundamentals for the next several quarters.

For the past two years, Houston has accounted for the majority of positive absorption within primary markets. And together with Dallas, those markets accounted for 75.7 percent of positive absorption in 2017. This number is down significantly at the start of the quarter, with only 34,997 square feet of absorption in Houston and 107,699 in Dallas: 8.6 percent of 2017 levels. Texas also has the second largest share of Toys “R” Us and Babies “R” Us locations after California and as a result, average U.S. power center fundamentals could feel the pressure without the Texas markets posting strong absorption numbers.

Power centers generally attract retailers that compete with e-commerce brands like Toys “R” Us, Staples and Sports Authority, and that, compounded with closures, makes power centers ripe for innovation. Power centers, like malls, could begin to see more grocers, fitness users and non-retail uses as strategies to backfill some of these spaces.

Power center vacancy falls but likely for the last quarter

Source: CoStar, JLL
California will be hit hardest with Toys “R” Us closures
Not surprisingly, the majority of Toys “R” Us and Babies “R” Us locations are in the most populous states: California, Texas, New York and Florida. California will see the greatest number of closures as the state has 12.8 percent of the Toys “R” Us inventory.

However, with closures come new opportunities for owners to backfill these spaces with well-performing retailers or new non-retail concepts. Home furnishings retailers like HomeGoods and HomeSense could be logical replacements for Toys “R” Us or Babies “R” Us considering their similar footprints. There are also reconfiguration opportunities within these spaces that could include carving existing stores into smaller footprints. The average Toys “R” Us store is approximately 30,000 square feet therefore, creating smaller floorplates would allow for greater retail diversity.

Some retailers have already put in bids or have expressed interest in bidding on the Toys “R” Us locations that are up for auction. Those retailers include Big Lots, home furnishings retailers Scandinavian Designs, Ashley Furniture, Raymour and Flanigan, and Gold & Tennis Pro Shop and PGA Tour Superstore.

Greatest concentrations of Toys “R” Us and Babies “R” Us locations are in most populous states: CA, TX, NY & FL

<table>
<thead>
<tr>
<th>State</th>
<th>% share of Toys “R” Us &amp; Babies “R” Us locations</th>
</tr>
</thead>
<tbody>
<tr>
<td>CA</td>
<td>12.8%</td>
</tr>
<tr>
<td>TX</td>
<td>7.8%</td>
</tr>
<tr>
<td>NY</td>
<td>6.9%</td>
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<tr>
<td>FL</td>
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<tr>
<td>PA</td>
<td>5.2%</td>
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<tr>
<td>NJ</td>
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<tr>
<td>IL</td>
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<tr>
<td>OH</td>
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<tr>
<td>MI</td>
<td>3.7%</td>
</tr>
<tr>
<td>VA</td>
<td>3.3%</td>
</tr>
</tbody>
</table>

Source: AggData
Neighborhood and community centers continue to lease up space

Demand remains for service-oriented retail as most markets are still seeing rising rents and falling vacancies. Grocery-anchored centers continue to see growth as several grocers announce aggressive expansion plans for 2018.
Increases in population help the demand for service-oriented retail

Despite a vacancy rate higher (7.3 percent) than the average for total retail (4.6 percent), shopping centers are still seeing declines in vacancy while other property types begin to stagnate or rise. However, rent growth is slowing with only a 60-basis-point increase quarter-over-quarter, compared to the previous quarter-over-quarter increase of 130 basis points.

Construction remains limited throughout the U.S., but Dallas saw approximately 460,000 square feet of new shopping center deliveries in the first quarter: 37.7 percent of all new shopping center projects in major markets. The Dallas–Fort Worth metro has seen the largest growth in population in the past year, with 146,000 new residents in 2017. The Texas markets have benefitted from both international and domestic migration which, in turn, create a demand for service-oriented retail. However, with 677,000 square feet of product still in the pipeline and absorption less than new deliveries for this quarter, there may be an excess of product on the market, which could cause vacancies to rise as the year progresses.

Shopping centers have the highest vacancy at 7.3 percent but compression continues

Demand for neighborhood and community center space has been fluctuating but remains consistently ahead of supply

Source: CoStar, JLL
Want more information?

Greg Maloney
President & CEO
+1 404 995 6315
greg.maloney@am.jll.com

James Cook
Americas Director of Research, Retail
+1 317 810 7191
jamesd.cook@am.jll.com

Naveen Jaggi
President, Retail Brokerage
+1 713 888 4087
naveen.jaggi@am.jll.com

Taylor Coyne
Research Manager, Retail
+1 213 239 6146
taylor.coyne@am.jll.com
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