

# MARKETBEAT

# San Diego Region

Retail H1 2017



## ECONOMIC INDICATORS

### National

|                          | Q2 16 | Q2 17 | 12-Month Forecast* |
|--------------------------|-------|-------|--------------------|
| GDP Growth               | 1.3%  | 2.3%  | ▲                  |
| CPI Growth               | 1.1%  | 1.9%  | ▲                  |
| Consumer Spending Growth | 2.7%  | 2.7%  | ▼                  |
| Retail Sales Growth      | 2.2%  | 4.0%  | ■                  |

\*Forecast by Cushman & Wakefield

### Regional

|                   | H1 16    | H1 17    | 12-Month Forecast |
|-------------------|----------|----------|-------------------|
| Household Income  | \$69,640 | \$71,683 | ▲                 |
| Population Growth | 0.8%     | 0.8%     | ▲                 |
| Unemployment      | 4.3%     | 3.6%     | ▼                 |

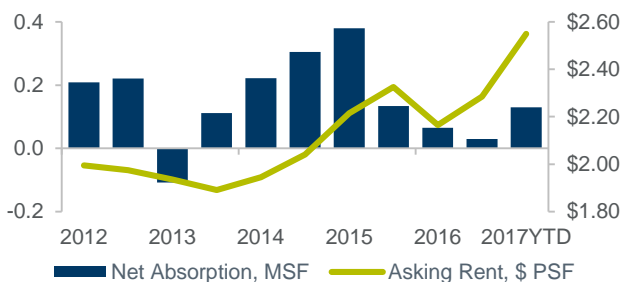
Source: Moody's Analytics, Ca. EDD

### Market Indicators

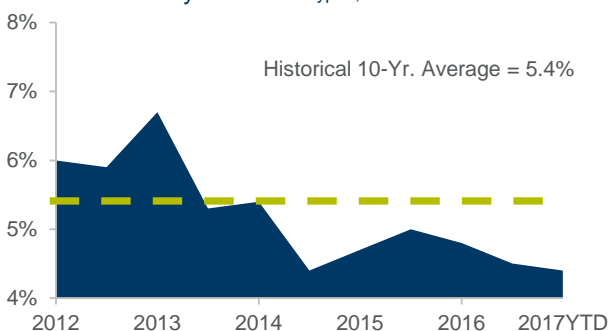
|                                  | H1 16  | H1 17  | 12-Month Forecast |
|----------------------------------|--------|--------|-------------------|
| Overall Vacancy - incl. Sublease | 4.8%   | 4.4%   | ▼                 |
| Direct Net Absorption SF         | (145K) | 57K    | ▲                 |
| Under Construction SF            | 346K   | 305K   | ▲                 |
| Average Asking Rent (NNN)        | \$2.05 | \$2.58 | ▲                 |

### Net Absorption/Asking Rent (Triple Net, Monthly)

2-HALF TRAILING AVERAGE



### Overall Vacancy – All Center Types, incl. Sublease



## Economy

The San Diego employment market continued to record job growth, adding 20,300 jobs (+1.4%) between May 2016 and May 2017. During the same time period, the unemployment rate decreased 70 basis points (bps), dropping to 3.6%. Last time the unemployment rate was this low was 11 years ago in May of 2006. The current rate is 240 bps below the 27-year average of 6%.

All employment sectors are expected to grow at a combined growth rate of 1.6% in 2017, according to Moody's Analytics. San Diego's economy of \$220.6 billion as measured by gross regional product grew an estimated 3.2% in 2016 - consistent with its 10-year average growth rate of 3.1% - and is forecasted to grow an additional 2.7% in 2017.

## Market Overview

Fueled by employment growth, San Diego's retail market continues to maintain steady occupancy. Favorable economic conditions and demographics make San Diego a premier market for current and expanding retailers. As of June 30, 2017, retail vacancy, including sublease, in San Diego stood at 4.4%. Vacancy is down 40 bps from the 4.8% mark posted a year ago and reflects a substantial decline of 280 bps from the peak post-recession vacancy level of 7.2% reported nine years ago. Compared to year-end 2016, vacancy decreased 10 bps as a result of tenants occupying 57,000 square feet (SF) countywide. 2016 was the fifth consecutive year of positive occupancy growth. The first half of 2017 sustained this positive trend.

Tenant demand continues to be driven by national and regional chains, most of which place the highest importance on the best-in-class centers within each trade area, fueling strong demand for Class A space. While some activity is spilling over into Class B and C assets, a shallow pool of mom and pop tenants has scarcely affected the pace of absorption. Because of strong demand for quality space, landlords of Class A centers are in the power position but tenants can still negotiate relative bargains for space at many Class B and C projects.

The best performing submarkets by square feet absorbed in the first half of 2017 were Mira Mesa (+70,600 SF), Poway (+63,600 SF) and Downtown (+54,600 SF). Tenants contributing to the positive absorption across these submarkets highlight established retail trends: expansion of fitness centers, home improvement and sporting goods stores.

Both coastal and high-income suburban locations remain popular and command premium rents for their locations. Del Mar, with a 5.3 % vacancy rate, remains the premier target for expanding retailers, keeping rents among the highest in the county, averaging \$7.95 PSF triple net per month due, in large part, to the availability at the prestigious Del Mar Highlands shopping center. Asking rents in Kearny Mesa, Rancho Bernardo, Solana Beach, Point Loma/Sports Arena, Carmel Mtn. Ranch/Rancho Penasquitos and Encinitas submarkets also topped the market. Rental rates in those submarkets ranged between \$3.11 and \$3.95 PSF triple net per month in the first half of 2017.

Construction in the San Diego market is driven by several factors including urban development and redevelopment, as well as the expansion of trophy projects in the best locations and outparcel/pad development in existing shopping centers.

Of the projects currently under construction, the majority are located in the urban locations of Downtown and Uptown. Notably, Park 12 located in Downtown is a mixed-use retail and residential development that is adjacent to Petco Park. Park 12 is set to be delivered in 2017, including 713 residential units and a 12,000-SF open air plaza. While located in suburban submarket, the Millenia development in Chula Vista with 131,000 SF of

retail under construction, strives to mimic urban development with walkable promenades, parks, services, shops and restaurants. It is billed as a “pedestrian paradise”.

An example of trophy retail development is Kilroy’s One Paseo shopping center, which held its ground-breaking ceremony in January 2017. Despite being scaled down from its original plan, One Paseo, a controversial 23.6-acre mixed-use environment, including office and residential, will total approximately 1.1 MSF. The first phase, to cost approximately \$225 million, includes 95,000 SF of retail and the initial segment of apartments, with retail tenants not yet announced.

Across the street from One Paseo, Donahue Schriber Realty Group, which originally opposed the One Paseo Project, announced a 120,000-SF expansion due to be completed in 2018. The centerpiece of the new Collection at Del Mar Highlands Town Center will be a 25,000-SF natural foods grocer Jimbo’s.

## CONSTRUCTION IS DRIVEN BY DEVELOPMENT OF TROPHY CENTERS IN THE BEST LOCATIONS AND URBAN MIXED-USE REDEVELOPMENT

An example of upcoming redevelopment is the 75,000-SF Del Mar Plaza retail center with panoramic ocean views that was acquired by Brixton Capital in February of 2017 for \$45.5 million. The Plaza is home to seven upscale dining options and national retailers such as Banana Republic and Lorna Jane. Brixton plans to revitalize and reimagine the well-known center by modernizing and elevating the overall appearance, tenant mix and community outreach in order to better meet the needs of local residents and visitors.

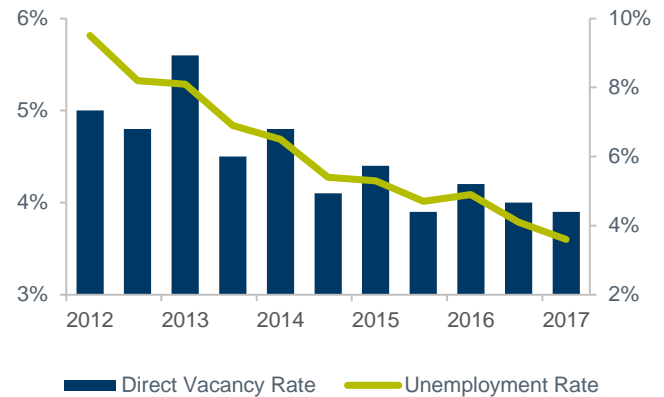
Additionally, the 40-year-old Westfield UTC has entered its Phase II of a \$600 million “resort-inspired transformation”, which commenced in summer 2015 and is expected to be completed by October 2017. This expansion, which will increase the total project size by 30%, will feature an additional 90 new shops and chef-driven restaurants (251,000 SF), an 18,000-SF indoor/outdoor event space as well as a palm-tree lined valet drop-off.

While Sears, one of the anchor stores, is on its way out with no announced replacement, a 149,000-SF two-level Nordstrom department store will debut October 12, 2017. Nordstrom will also introduce a contemporary restaurant named Bazille with a full bar and patio overlooking the mall. Additional announced restaurants include Larsen’s Steakhouse, San Diego based Napizza, Javier’s (from Newport Beach), Din Tai Fung, Arbor, Smokeyard BBQ and Chop House, True Food Kitchen, Great Maple and Winery Restaurant & Wine Bar.

The department store sector continues to feel growing pains, as Macy’s announced the closure of 100 stores during 2017. The closures included a location at Westfield Mission Valley which had been open since 1961. Nordstrom also closed their Westfield Horton Plaza location in 2016 due to lagging sales; however, Westfield has purchased the prime downtown real estate and will consider redevelopment opportunities. Sears announced a closure of 28 stores nationwide including the Westfield UTC location. BCBG Max Azria Group announced a closure of 118 locations nationwide, including the locations at the Westfield Horton Plaza in Downtown and Carlsbad Outlet mall due to Chapter 11 bankruptcy filing.

### Direct Vacancy vs. Unemployment Rate

VACANCY AT 3.9% - BELOW 10-YR. AVG. RATE OF 4.5%



### Retail Tenant Categories 2017/2018

| New to Market/Expanding   | Downsizing/Consolidating            |
|---|-------------------------------------|
| Fast Casual Restaurant Concepts, Fast Food                      | Department Stores                   |
| Breweries/Brew Pubs   | Drug Stores                         |
| Food Halls/Artisanal Markets                                    | Mid-Priced Apparel                  |
| Grocery Stores – Specialty, Organic, Ethnic, Off-Price/Discount | Mid-Priced/Unionized Grocery Stores |
| Fitness/Health Clubs  | Office Supplies                     |
| Personal Services – Salons, Spas                                | Consumer Electronics                |

### Outlook

- Strong demand for space in San Diego County will continue through 2017 as a result of its strong demographics. Limited space opportunities and constrained supply will drive rents upward, particularly in Class A centers and in urban areas.
- New construction or redevelopment will continue in response to the constrained supply. Developers and landlords will seek opportunities to create amenity-rich experiences in mixed-use environments. Luxury and upscale retail concepts will continue to expand with nearly all of their growth occurring in urban settings. Tenants will also seek out spaces in new development at Class A centers in the best locations.

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## San Diego Region

Retail H1 2017



| SUBMARKET      | TOTAL BLDGS | INVENTORY         | SUBLET VACANT  | DIRECT VACANT    | VACANCY RATE | CURRENT DIRECT NET ABSORPTION | YTD DIRECT NET ABSORPTION | UNDER CONSTRUCTION | AVERAGE ASKING RENT (ALL Types) |
|----------------|-------------|-------------------|----------------|------------------|--------------|-------------------------------|---------------------------|--------------------|---------------------------------|
| North County   | 130         | 19,411,190        | 77,486         | 1,055,109        | 5.8%         | (20,775)                      | (20,775)                  | 3,900              | \$2.17                          |
| Central County | 95          | 14,105,638        | 85,977         | 349,279          | 3.1%         | 165,455                       | 165,455                   | 0                  | \$5.33                          |
| South County   | 206         | 17,028,752        | 83,011         | 712,675          | 4.7%         | (73,105)                      | (73,105)                  | 301,288            | \$2.24                          |
| East County    | 66          | 8,903,386         | 55,684         | 220,014          | 3.1%         | (14,560)                      | (14,560)                  | 0                  | \$1.69                          |
| <b>TOTAL</b>   | <b>497</b>  | <b>59,448,966</b> | <b>302,158</b> | <b>2,337,077</b> | <b>4.4%</b>  | <b>57,015</b>                 | <b>57,015</b>             | <b>305,188</b>     | <b>\$2.58</b>                   |
| Community      | 96          | 17,045,441        | 65,629         | 622,671          | 4.1%         | 68,617                        | 68,617                    | 3,900              | \$2.28                          |
| Freestanding   | 19          | 669,496           | 0              | 110,781          | 16.5%        | 16,396                        | 16,396                    | 6,435              | \$1.19                          |
| Neighborhood   | 233         | 23,252,931        | 176,857        | 1,116,872        | 5.6%         | (78,885)                      | (78,885)                  | 131,005            | \$2.14                          |
| Power          | 28          | 11,494,571        | 39,076         | 214,545          | 2.2%         | 27,373                        | 27,373                    | 0                  | \$5.63                          |
| Regional       | 9           | 3,627,952         | 8,745          | 57,282           | 1.8%         | (26,359)                      | (26,359)                  | 0                  | \$2.86                          |
| Strip          | 112         | 3,358,575         | 11,851         | 214,926          | 6.8%         | 49,873                        | 49,873                    | 163,848            | \$2.55                          |
| <b>TOTAL</b>   | <b>497</b>  | <b>59,448,966</b> | <b>302,158</b> | <b>2,337,077</b> | <b>4.4%</b>  | <b>57,015</b>                 | <b>57,015</b>             | <b>305,188</b>     | <b>\$2.58</b>                   |

Rental rates reflect triple net (NNN) asking rents \$psf/monthly. Vacancy rate includes direct and sublease. Net absorption excludes sublease.

### Key Lease Transactions H1 2017

| PROPERTY                 | SF     | TENANT                     | LANDLORD                     | TRANSACTION TYPE | SUBMARKET                      |
|--------------------------|--------|----------------------------|------------------------------|------------------|--------------------------------|
| 443 College Blvd.        | 86,079 | Target                     | Retail Insite                | Direct           | Oceanside                      |
| 14340 Penasquitos Dr.    | 57,580 | Floor & Décor Shop         | Brixton Capital              | Sublease         | Carmel Mtn./Rancho Penasquitos |
| 701 5th Ave.             | 53,869 | TCL Theatre                | Oliver McMillan              | Direct           | Downtown                       |
| 14721-14857 Pomerado Rd. | 44,686 | Poway International Market | Regency Centers              | Direct           | Poway                          |
| 999 N. Broadway          | 43,500 | El Super                   | Pacific Development Partners | Direct           | Escondido                      |

### Key Sale Transactions H1 2017

| PROPERTY                                  | SF      | BUYER                               | SELLER                         | SALE PRICE               | SUBMARKET     |
|---|---------|-------------------------------------|--------------------------------|--------------------------|---------------|
| Campus Marketplace                        | 149,352 | InvenTrust Properties               | Emerald Interests Group        | \$73,350,000 (\$491 PSF) | San Marcos    |
| Del Mar Plaza                             | 74,631  | Brixton Capital                     | GLL Real Estate Partners, Inc. | \$45,500,000 (\$610 PSF) | Del Mar       |
| Sweetwater Crossings                      | 165,013 | Merlone Geier                       | Sweetwater Investments, Inc.   | \$36,500,000 (\$221 PSF) | National City |
| Palm Promenade 24/770 Dennerly Rd. & Land | 86,610  | Citivist Commercial Investments LLC | EPR Properties REIT            | \$36,000,000 (\$416 PSF) | Chula Vista   |
| The Beachwalk                             | 54,973  | GEM OPS LLC                         | The Muller Company             | \$33,250,000 (605 PSF)   | Solana Beach  |

### Under Construction H1 2017 – selected projects 10,000 SF+

| PROPERTY                           | RELEASED |        |        | ADDRESS                          | CENTER TYPE  | ESTIMATED COMPLETION | SUBMARKET   |
|------------------------------------|----------|--------|--------|----------------------------------|--------------|----------------------|-------------|
|                                    | SF       | SF     | %      |                                  |              |                      |             |
| Millenia Retail                    | 131,005  | 0      | 0.0%   | SEC. SR-125 Toll Rd. & Birch Rd. | Neighborhood | 2017                 | Chula Vista |
| Park 12                            | 45,360   | 0      | 0.0%   | 202 Park Blvd.                   | Strip Center | 2017                 | Downtown    |
| BRIC Broadway + Pacific - Phase II | 32,850   | 0      | 0.0%   | 900 Bayfront Ct.                 | Strip Center | 2018                 | Downtown    |
| Makers Quarter - The Coliseum      | 20,500   | 20,500 | 100.0% | 1485 E St.                       | Strip Center | 2017                 | Downtown    |
| Pacific Gate                       | 16,000   | 0      | 0.0%   | 850 E St.                        | Strip Center | 2017                 | Downtown    |

## RETAIL SUBMARKETS

### SAN DIEGO



## About Cushman & Wakefield

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