Retail Research

Market Report

Second Half 2018

Chicago Metro Area

Marcus & Millichap

Retailers Increasingly Consider Chicago For New Concept Launches

Retailers targeting Chicago for their flagship stores. Rising household incomes supported by corporate expansions are giving consumers increased discretionary income and attracting retailers to the Chicago metro. New York & Co. opened its largest flagship store on State Street earlier this year. Additionally, Amazon opened one of its convenience stores in the metro at the end of September. Several other retailers are considering opening flagship stores within the market, including Google and Funko, a company that manufactures pop culture items. Expansions like these will continue to bode well for vacancy improvement. Presently, the rate fell for a fourth consecutive year during the past 12 months ending in June amid strong net absorption.

Demand outpaces supply in the suburbs. Construction of retail space is beginning to moderate after several years of elevated development. The bulk of completions remain in the suburbs. Despite heightened deliveries here, strong net absorption continues to sustain demand for retail space, dropping vacancy at a faster pace than the metro average and supporting healthy rent growth. Moving forward, completions will remain concentrated in outlying areas, though supply additions will likely have a minimal impact on vacancy as much of the space is pre-leased or built-to-suit.

Retail 2018 Outlook

2.0 million sq. ft. will be completed

Construction: Development slows moderately from the 2.3 million square feet completed in 2017. More than half of this year's deliveries are single-tenant properties.

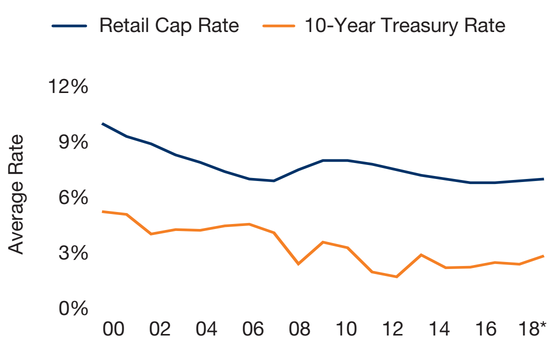
40 basis point decrease in vacancy

Vacancy: Net absorption of 3.5 million square feet will tick vacancy down 40 basis points in 2018 to 6.2 percent. Last year, the rate also fell 40 basis points.

3.4% increase in asking rents

Rents: The average asking rent picks up from the 0.9 percent increase recorded in the prior year, reaching $17.60 per square foot in 2018.

Local Retail Yield Trends



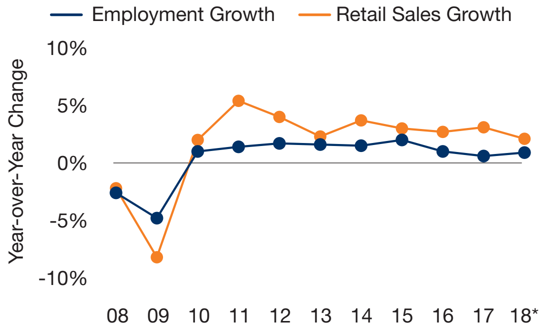
* Cap rates trailing 12 months through 2Q18; 10-Year Treasury up to June 29.
Sources: CoStar Group, Inc.; Real Capital Analytics

Investment Trends

- Buyers in the $1 million to $10 million price tranche are leading transaction velocity in Chicago, with both out-of-state and local investors bidding for available assets. Buyers from California are particularly active targeting properties upward of 200 basis points higher than their home markets. First-year yields for retail assets overall averaged in the low-7 percent band during the past 12 months.
- Demand picked up considerably in the Northwest City submarket with the number of sales rising 20 percent in the area during the past 12 months. Heightened demand in the submarket lifted the average price 4 percent to $380 per square foot. Here, cap rates averaged in the low-7 to mid-7 percent range based on property type and location.
- Buyers remain interested in multi-tenant assets as these buildings change hands with first-year returns in the mid-7 to low-8 percent band.

2Q18 - 12-MONTH TREND

Employment vs. Retail Sales Trends

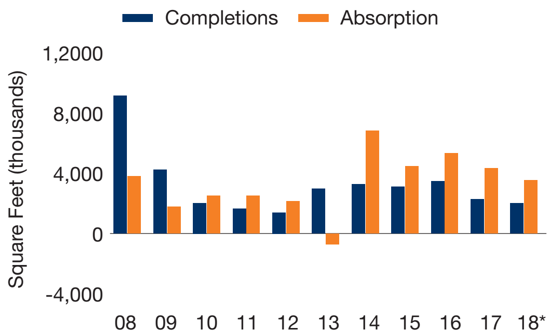


EMPLOYMENT:

0.8% increase in total employment Y-O-Y

- Approximately 38,800 positions were created during the year ending in June, following a 1.2 percent increase in the prior year. The jobless rate fell 70 basis points during the past 12 months to 4.2 percent.
- Hiring was led by the education and health services sector during the prior four quarters with the creation of more than 10,000 positions.

Retail Completions

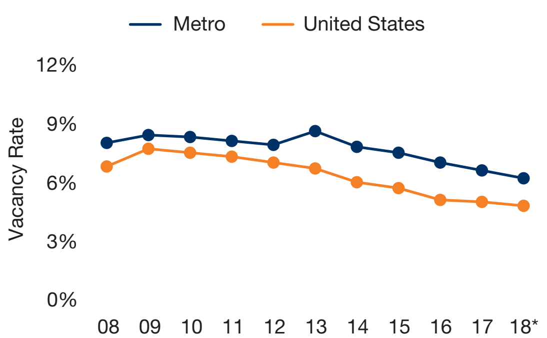


CONSTRUCTION:

1.8 million square feet completed Y-O-Y

- **Urban:** Since last July, more than 372,000 square feet of retail space was completed, much of which was located in the Northwest City submarket.
- **Suburban:** The majority of completions were located in the suburbs as 1.4 million square feet of space was delivered. Construction was widespread throughout suburban Chicago with most submarkets receiving retail space.

Vacancy Rate Trends

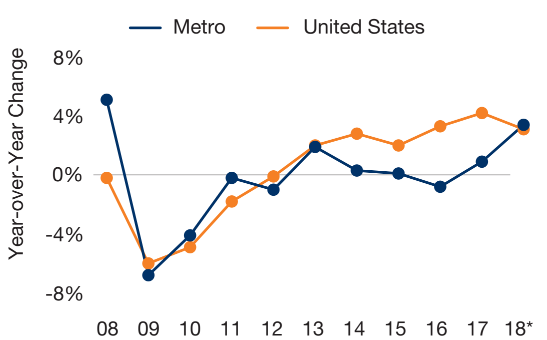


VACANCY:

40 basis point decrease in vacancy Y-O-Y

- **Urban:** Net absorption of 59,000 square feet of space did not outpace completions, lifting vacancy 40 basis points to 4.7 percent. In the prior year, vacancy fell 80 basis points.
- **Suburban:** In the suburbs, vacancy fell 50 basis points during the past four quarters to 6.8 percent as 3.4 million square feet was absorbed. Vacancy in the Schaumburg area plummeted 130 basis points during this time.

Asking Rent Trends



RENTS:

1.9% increase in the average asking rent Y-O-Y

- **Urban:** The average asking rent declined 1 percent during the year to $25.63 per square foot in June, nulling the nearly 1 percent increase recoded in the prior annual period.
- **Suburban:** The suburbs registered stronger-than-metro-average growth, with the average asking rent climbing 3.2 percent during the past 12 months to $15.68 per square foot. Last year, rent edged up 1.3 percent.

* Forecast

DEMOGRAPHIC HIGHLIGHTS

2018 JOB GROWTH*
Metro 0.9%
U.S. Average 1.6%

FIVE-YEAR POPULATION GROWTH**
32,000 or 0.07% Annual Growth
U.S. 0.7% Annual Growth

FIVE-YEAR HOUSEHOLD GROWTH**
125,000 or 0.7% Annual Growth
U.S. 1.1% Annual Growth

2Q18 MEDIAN HOUSEHOLD INCOME
Metro $70,671
U.S. Median $60,686

2Q18 RETAIL SALES PER MONTH
$3,929 Per Household
U.S. $3,925
$1,500 Per Person
U.S. $1,506

RETAIL SALES FORECAST**
Metro 15.6%
U.S. 20.0%

* Forecast **2017-2022

SUBMARKET TRENDS

Lowest Vacancy Rates 2Q18

Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Asking Rent	Y-O-Y % Change
Jasper County	1.2%	-40	$7.31	1.0%
East Loop	2.2%	40	$30.00	-33.3%
Gold Coast/Old Town	2.6%	40	$18.64	-34.3%
West Loop	2.8%	-210	$36.07	20.2%
Grundy County	3.3%	-90	$14.56	-6.1%
Lincoln Park	4.5%	40	$31.83	-0.9%
South Loop	4.6%	100	$34.99	10.7%
Kenosha County	4.7%	-40	$11.39	6.0%
Northwest City	4.7%	60	$22.54	12.8%
River West	4.8%	-290	$43.50	-2.9%
South Chicago	4.8%	-80	$18.31	-2.2%
Overall Metro	**6.4%**	**-40**	**$17.38**	**1.9%**

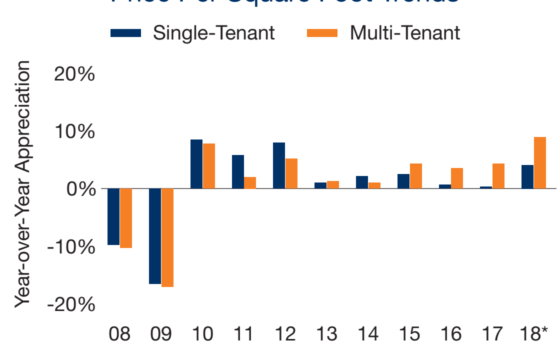
SALES TRENDS

Higher Average First-Year Returns Lure Buyers to Strip Centers

- **Multi-Tenant:** The number of multi-tenant transactions over the past 12 months prior to June has held steady from the previous annual time period. Increased competition for available assets lifted the average price 9 percent to $265 per square foot.
- **Single-Tenant:** Transaction volume for single-tenant assets fell 4 percent during this time. Properties traded around $345 per square foot on average, up 4 percent year over year.

Outlook: Strip centers remain popular, particularly in the Joliet/Central Will County and Northwest City submarkets.

Price Per Square Foot Trends



* Trailing 12 months through 2Q18 over previous time period.
Pricing trend sources: CoStar Group, Inc.; Real Capital Analytics

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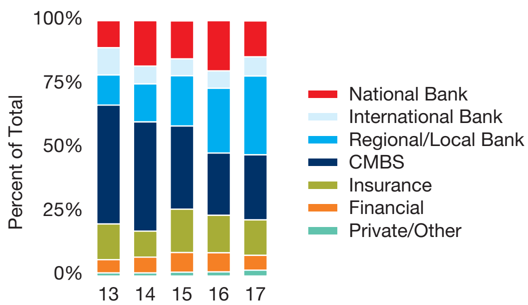
10-Year Treasury vs. 2-Year Treasury Yield Spread Tightens

Retail Mortgage Originations by Lender



* Through Sept. 26
Sources: CoStar Group, Inc.; Real Capital Analytics

CAPITAL MARKETS

By DAVID SHILLINGTON, President,
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Fed raises benchmark rate, plans for additional increases. The Federal Reserve recently increased the federal funds rate by 25 basis points, lifting the overnight lending rate to 2 percent at the conclusion of its September meeting. The Fed noted inflation has broadly reached its target, while household spending and corporate investment remain robust. The Fed indicated an additional rate hike this year and projects as many as three increases in 2019.

Lending costs rise alongside Fed rate increase. As the Fed lifts rates, lenders have been tightening margins to compete for loans. Despite these efforts, borrowing costs remain on an upward trajectory, which is tightening returns and pushing some investors to seek greater yields in secondary markets. However, though buyers may try to push back on pricing due to increased loan costs, some sellers remain convinced that the strong economy and sturdy NOI performance substantiate aggressive pricing and a widening expectation gap is the result. If interest rates rapidly surge upward, this gap could quickly widen, slowing transaction activity.

The capital markets environment remains competitive. As the Fed tightens policy, global investors have been acquiring Treasurys in order to capture a considerable yield premium, keeping the 10-year Treasury near 3 percent. Portfolio lenders are providing debt for retail assets, with leverage typically capped at 60 to 65 percent. The sector has become increasingly nuanced, with deals more scrutinized due to e-commerce competition. Ten-year loan structures will range between 4.95 and 5.25 percent, depending on tenancy, location and sponsorship. Continued consumer spending underpins U.S. growth, supporting retail demand and driving a 10-basis-point decline in vacancy to 4.9 percent this year.

National Retail Group

Visit www.NationalRetailGroup.com

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Sources: Marcus & Millichap Research Services; Bureau of Labor Statistics; CoStar Group, Inc.; Experian; Moody's Analytics; Real Capital Analytics; TWR/Dodge Pipeline; U.S. Census Bureau