MARKET FORECAST

RETAIL

Chicago Metro Area

IPA INSTITUTIONAL PROPERTY ADVISORS

Q2/19

Market Moves Slower as Owners Explore Ways to Fill Empty Space

Chicago recalibrating as the retail sector remains in transformation stage. The wave of store closures over the past several years is beginning to impact Chicago. Space is being absorbed; however, it is occurring at a much slower pace than in prior years, particularly as empty big-box stores require larger format retailers or even several smaller vendors to occupy the entire block. Substantial vacancy decreases witnessed in previous years are turning into minimal movements as the market adjusts to the influx of available space. This has reduced the need for new construction and has weighed on rental gains. Though rent growth in the Windy City has been rather inconsistent over the past decade, rate reductions are becoming more prevalent as owners sacrifice some profitability to attract new tenants and keep their retail centers full.

Builders enticed by economic growth in urban core. An inflow of downtown jobs is bringing developers to the core as they look to capitalize on the infusion of new households. Well-paid young professionals in neighborhoods like Fulton Market and West Loop are providing a boost to the area's spending power, bringing a deeper pool of retailers to the CBD. Recently approved megadevelopments in Lincoln Yards and The 78 will further strengthen the downtown retail market in the coming years. Construction across the metro's suburbs this year will be widely dispersed yet with one focal point in Wheeling, where a transit-oriented, mixed-used project includes 100,000 square feet of retail space slated for a 2019 delivery.

Retail 2019 Outlook

1.7 million SQ. FT.
will be completed

CONSTRUCTION:

Development will decrease for the third year in a row as deliveries reach their lowest level since 2012. Completions will be concentrated near the core.

0 BASIS POINT
change in vacancy

VACANCY:

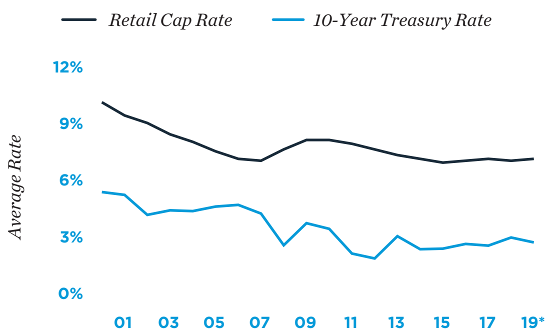
Vacancy will remain at 6.5 percent as supply and demand realign. Last year, the market rate inched up 10 basis points.

2.1% INCREASE
in asking rents

RENTS:

Rent growth exceeds its sub-1 percent previous five-year average as Chicago's average asking rent moves to $17.65 per square foot.

Local Retail Yield Trends



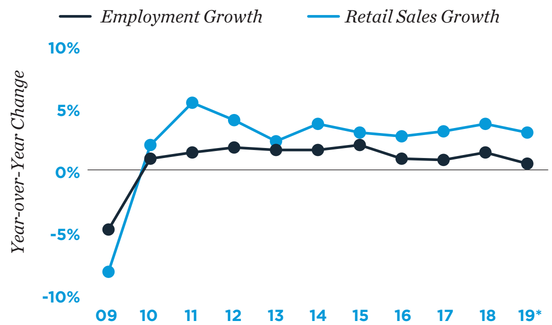
** Cap rates trailing 12 months through 1Q19; 10-year Treasury up to March 29*

Sources: CoStar Group, Inc.; Real Capital Analytics

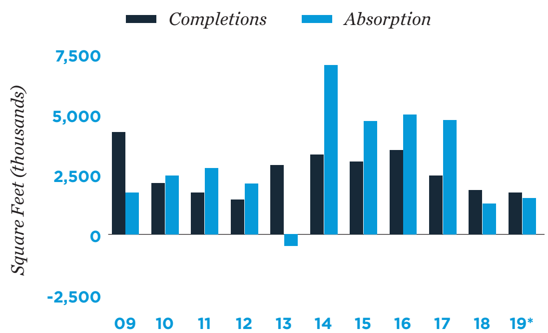
Investment Trends

- Experiential destinations like entertainment retailers, health clubs and a variety of eateries were popular among investors as they seeks tenants with greater defense against internet-oriented alternatives. Many western and northern suburbs catered to these preferences, luring private buyers as well as several out-of-state and foreign investors.
- Older neighborhoods just north of downtown remained targeted areas for local investors as assets in the $2 million to $5 million range are widespread. Avondale, Irving Park and Lincoln Park were combed through as relatively tight vacancy makes these communities particularly attractive.
- Affordable price points in Northwest Indiana drew many entry-level investors. Cap rates reaching 10 percent extended far above many other Chicago suburbs, making this portion of the metro especially enticing for high-yield strategies. Continuing growth in this region is further suburbanizing the area and making it more attractive for some national retail tenants.

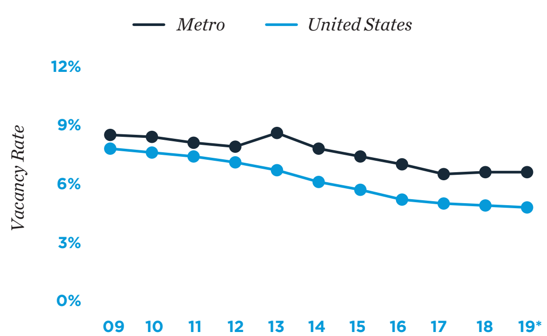
Employment vs. Retail Sales Trends



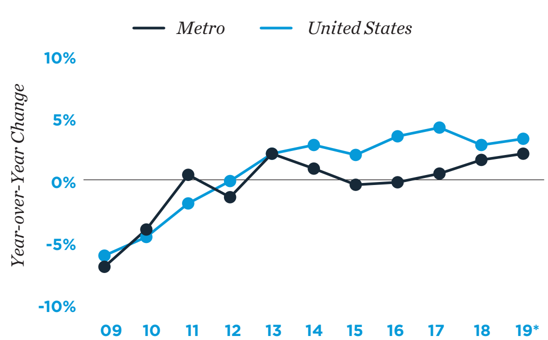
Retail Completions



Vacancy Rate Trends



Asking Rent Trends



**Forecast*

Sources: CoStar Group, Inc.; Real Capital Analytics

1Q19 – 12-Month Trend

EMPLOYMENT

1.4% increase in total employment Y-O-Y

- Hiring activity over the past 12 months stayed restrained as 45,200 jobs were created, in line with the previous year. Despite slowed employment growth, the jobless rate moved down 70 basis points to 4.0 percent.
- The education and health services sector led hiring with roughly 14,000 workers. Manufacturing and trade, transportation and utilities sectors each added about 8,500 employees.

CONSTRUCTION

1.8 million square feet completed Y-O-Y

- **Urban:** Nearly 500,000 square feet of retail space was completed over the past year. Lincoln Park received roughly half of that total, more than any other urban submarket.
- **Suburban:** Development in suburban Chicago tapered off as roughly 1.3 million square feet was delivered. The Central North submarket, which includes Lake Forest, Vernon Hills and several other communities, logged more than 700,000 square feet.

VACANCY

30 basis point increase in vacancy Y-O-Y

- **Urban:** New supply weighed on the core as only 160,000 square feet was absorbed, pushing the urban vacancy rate up 40 basis points to 4.5 percent.
- **Suburban:** Over the past year, vacancy rose 20 basis points to 6.9 percent as low levels of absorption trickled out to the suburbs. One year earlier, the measure dipped 40 basis points.

RENTS:

1.6% increase in the average asking rent Y-O-Y

- **Urban:** Strong demand for storefronts as well as new construction supported a 13 percent boost to the average asking rent, driving it to $29.07 per square foot.
- **Suburban:** Wide-ranging vacancy movements across suburban Chicago ultimately pushed the average asking rent down 2.2 percent to $15.22 per square foot.

Demographic Highlights

2019 Job Growth*

Metro **0.6%**

U.S. Average **1.3%**

Five-Year Population Growth**

12,300 *or* **0.0%** *Annual Growth*

U.S. **0.6%** *Annual Growth*

Five-Year Household Growth**

112,100 *or* **0.6%** *Annual Growth*

U.S. **1.0%** *Annual Growth*

1Q19 Median Household Income

Metro **$71,615**

U.S. Median **$64,259**

1Q19 Retail Sales per Month

$4,051 *Per Household*

U.S. **$3,971**

$1,595 *Per Person*

U.S. **$1,544**

Retail Sales Forecast**

Metro **13.6%**

U.S. **16.9%**

** Forecast ** 2018-2023*

SUBMARKET TRENDS

Lowest Vacancy Rates 1Q19

Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Asking Average Rent	Y-O-Y % Change
Kenosha County	3.3%	-160	$11.41	5.6%
West Loop	3.5%	10	$34.37	-4.9%
O'Hare	3.8%	-50	$20.43	11.3%
Northwest City	3.9%	10	$22.12	1.9%
South Loop	4.2%	-60	$32.00	-7.9%
Lincoln Park	4.9%	150	$32.90	3.5%
South Chicago	4.9%	10	$17.73	-3.9%
Central Northwest	5.2%	-140	$14.20	-3.2%
Near North	5.5%	-30	$19.02	-0.3%
River West	5.5%	-10	$47.94	11.3%
River North	5.7%	-60	$39.20	10.5%
Overall Metro	**6.5%**	**30**	**$17.51**	**1.6%**

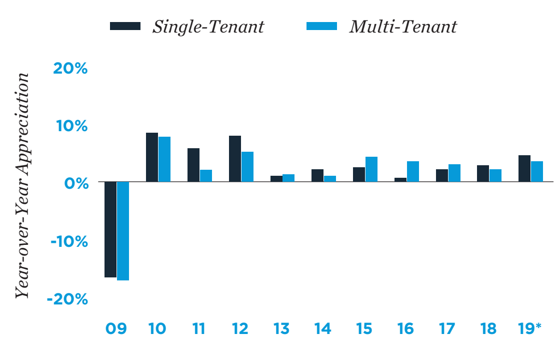
SALES TRENDS

Buyer Interest Still Strong, But Property Taxes May Impact Investment Strategies Moving Forward

- **Multi-Tenant:** Deal flow remained relatively steady year over year as interest in assets in some of the metro's most affluent areas stayed strong. During that time, the average cap rate ticked up 20 basis points to 7.5 percent.
- **Single-Tenant:** An appetite for health clubs and dining options kept trading activity stable since last March, supporting a 20-basis-point decrease to the average initial yield, putting it at 6.4 percent.

Outlook: High property taxes will continue to put pressure on retail owners, driving up operational costs and weighing on profits, particularly as the potential to substantially raise rents remains limited.

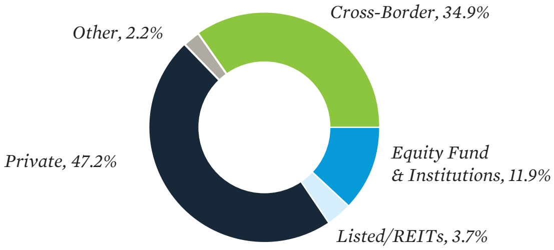
Price Per Square Foot Trends



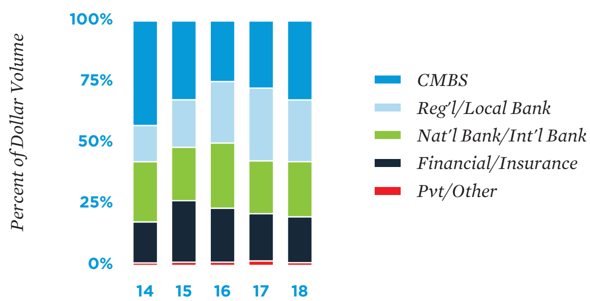
** Trailing 12 months through 1Q19 over previous time period*

Pricing trend sources: CoStar Group, Inc.; Real Capital Analytics

1Q19* Retail Acquisitions By Buyer Type



Retail Mortgage Originations By Lender



** Trailing 12 months through 1Q19*
Include sales $2.5 million and greater
Sources: CoStar Group, Inc.; Real Capital Analytics

CAPITAL MARKETS

By DAVID G. SHILLINGTON, President, Marcus & Millichap Capital Corporation

- **International pressures weigh on domestic outlook; Fed remains patient.** Amid ongoing trade disputes between the U.S. and China and slowing growth throughout the European economy, the global economic outlook has become more cautious. Market volatility, combined with muted sentiment, has sponsored a flight to the safety of Treasurys, pushing the 10-year yield below 2.6 percent. While domestic growth has moderated recently, the waning impact of the tax cut stimulus will likely trim forward estimates further. As a result, the Fed decided to cease reducing its balance sheet reduction through quantitative tightening by September and removed the potential for rate increases through the remainder of the year. The bond market has begun to price in a much more dovish Fed, with flattening interest rates reflecting more caution. Fed officials will likely focus on the intersection of a global growth slowdown and continued labor market strength to refine their plans moving forward, keeping interest rates stable for the foreseeable future.
- **Malls, legacy big-box players cloud otherwise optimistic retail landscape; underwriting remains conservative.** Uncertainty surrounding legacy retailers and the ongoing shift of consumer purchasing preferences to online sources have begun to weigh on retail sentiment, with lenders proving more cautious and conservative than in prior years of the cycle. Active lenders include local, regional and national banks, and insurance companies, with a primary lender focus on net-leased assets and premier mixed-use structures being highly desirable. Meanwhile, outlying malls and non-credit tenants will undergo much more scrutiny. This has created a two-tier market structure, with loan-to-value (LTV) ratios in the 55 to 75 percent range depending on borrower, asset and location factors. Mezzanine and bridge loan structures have been more frequently used in this environment, with owners undertaking capital improvements at higher leverage ratios on the short-term debt before seeking long-term financing options once their operations have been proved.

National Retail Group

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Price: $250

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