Marcus & Millichap

Retail Research
Market Report
San Antonio Metro Area

Second Quarter 2018

Developers, Investors Remain Focused On Northern San Antonio

Retailers concentrate on existing space as demand outweighs limited supply this year. Steady employment growth has resulted in a healthy stream of new residents to San Antonio over the past several years, encouraging retailers to expand. Developers have struggled to keep pace with robust tenant demand, and vacancy has tightened 100 basis points below the national average. Completions dip for a second consecutive year in 2018, as deliveries remain less than half of the 10-year average, and expanding retailers will be forced to compete for limited space in existing centers. As a result, the vacancy rate remains on a downward spiral this year.

Vacancy tightest in submarkets with minimal new supply. Developers have completed nearly 4.6 million square feet of retail space in northern submarkets since 2012, compared with approximately 2.4 million square feet throughout the rest of the metro during the span. Scant completions elsewhere in the market have resulted in vacancy retreating well below the overall average for eight out of 12 submarkets. While completions remain heavy in the north, vacancy stays above the metrowide average through the rest of the year.

Retail 2018 Outlook

660,000 sq. ft. will be completed

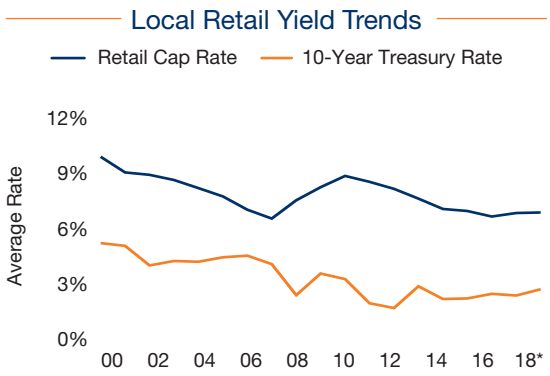
Construction:
Deliveries fall below 1 million square feet for a second consecutive year following five straight years of completions over this total.

20 basis point decrease in vacancy

Vacancy:
The absorption of more than 800,000 square feet of retail space pushes down vacancy to 4.0 percent this year.

1.3% increase in asking rents

Rents:
The average asking rent rises to $15.59 per square foot this year, reversing a dip of 0.3 percent during 2017.



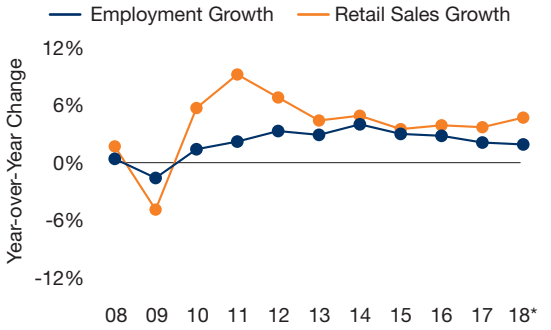
Investment Trends

- Strong demographic and economic growth trends in the northern portion of San Antonio are prompting heavy investment activity. More than two-thirds of sales occurred in these submarkets, changing hands at an average cap rate in the low- to mid-7 percent span.
- Strip centers are in high demand throughout the metro, and with retail completions on the decline, competition for available listings is intense. Despite an increase in interest rates this year, healthy competition has kept cap rates in the low-7 percent area for new product, trending up 100 basis points depending on property age and tenancy.
- Existing properties with vacancies or leases expiring soon will benefit from another year of reduced completions as expanding retailers fill these spaces. Investors will target these assets, as well as those in need of capital and management improvements, for upside potential.

* Cap rates trailing 12 months through 1Q18; 10-Year Treasury up to March 29, 2018
Sources: CoStar Group, Inc.; Real Capital Analytics

1Q18 - 12-MONTH TREND

Employment vs. Retail Sales Trends

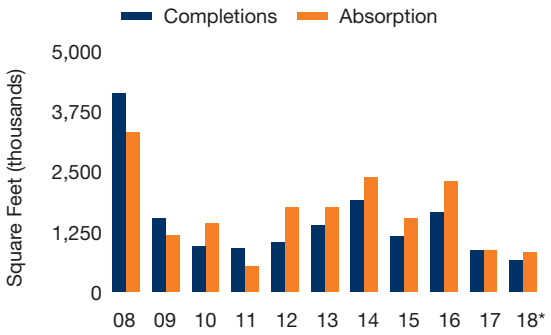


EMPLOYMENT:

1.8% increase in total employment Y-O-Y

- The construction and trade, transportation and utilities sectors added 4,400 and 3,800 positions, respectively, over the past year, leading employment gains. These additions contributed to total job creation of 18,400 during the past 12 months.
- The unemployment rate sank 70 basis points during the past four quarters to 3.4 percent.

Retail Completions

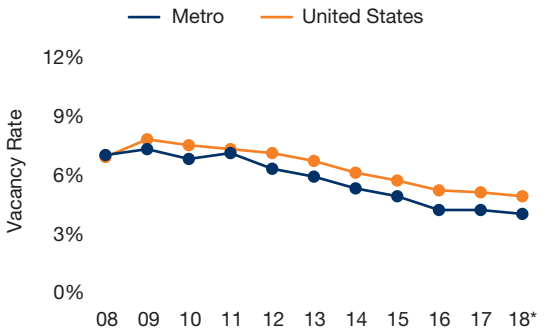


CONSTRUCTION:

743,000 square feet completed Y-O-Y

- Developers completed 66,000 square feet of space during the first quarter of the year as the pace of deliveries slows during 2018. More than 175,000 square feet was brought online in the first three months last year.
- Nearly 300,000 square feet of retail space is underway in the northern portion of the metro as deliveries remain concentrated here through the remainder of the year.

Vacancy Rate Trends

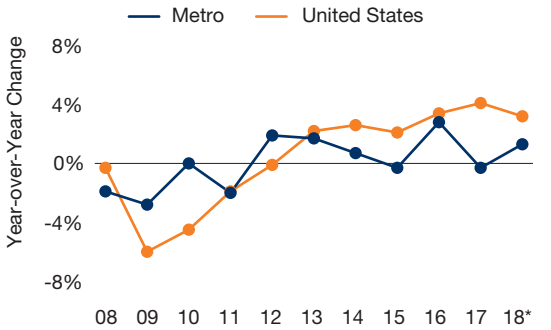


VACANCY:

40 basis point decrease in vacancy Y-O-Y

- A reduced level of deliveries has been met with still strong demand, driving retail vacancy down to 4.0 percent in the first quarter. This rate matches a cyclical low also recorded in the second quarter of 2016.
- Vacancy in North Central and Northeast San Antonio are some of the highest in the metro, at 5.4 percent and 4.9 percent, respectively.

Asking Rent Trends



RENTS:

3.4% decrease in the average asking rent Y-O-Y

- The average asking rent reached its highest level since the recession during the first quarter last year but has since retreated to $15.18 per square foot.
- Absorption of existing square footage has resulted in the space available for lease primarily in older buildings in need of upgrades or repositioning, prompting the decline in marketed rents since March of last year.

* Forecast

DEMOGRAPHIC HIGHLIGHTS

2018 JOB GROWTH*

Metro 1.9%

U.S. Average 1.2%

FIVE-YEAR POPULATION GROWTH**

201,800 or 1.6% Annual Growth

U.S. 0.7% Annual Growth

FIVE-YEAR HOUSEHOLD GROWTH**

80,000 or 1.7% Annual Growth

U.S. 1.1% Annual Growth

1Q18 MEDIAN HOUSEHOLD INCOME

Metro $58,563

U.S. Median $60,686

1Q18 RETAIL SALES PER MONTH

$4,316 Per Household

U.S. $3,922

$1,550 Per Person

U.S. $1,506

RETAIL SALES FORECAST**

Metro 21.0%

U.S. 19.7%

* Forecast **2017-2022

SUBMARKET TRENDS

Lowest Vacancy Rates 1Q18

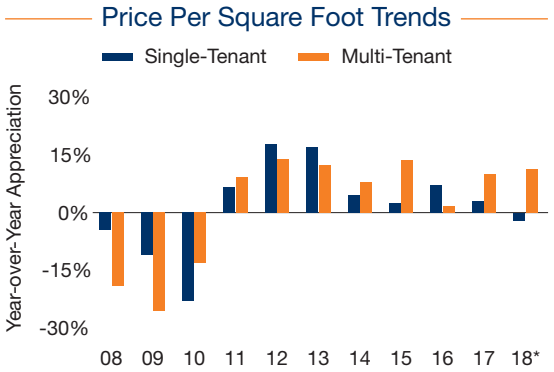
Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Asking Rent	Y-O-Y % Change
Atascosa County	1.3%	10	$14.55	-12.3%
CBD	2.1%	10	$21.75	3.4%
Kendall County	2.8%	40	$13.38	-11.3%
South	3.1%	-20	$13.83	-7.6%
Wilson County	3.2%	0	$17.40	-1.4%
Guadalupe County	3.3%	-80	$10.98	-23.4%
Northwest	3.6%	-80	$13.47	-5.9%
Comal County	3.7%	-10	$17.74	-7.1%
Northeast	4.9%	-150	$13.14	-2.6%
North Central	5.4%	60	$18.43	4.1%
Medina County	7.0%	-180	$16.66	-27.6%
Overall Metro	**4.0%**	**-40**	**$15.18**	**-3.4%**

SALES TRENDS

Buyer Competition Rises as Reduced Pace of Deliveries Squeezes Available Listings

- **Multi-Tenant:** Assets priced between $1 million and $10 million remain the bulk of sales. These properties sold for an average price per square foot near $237 and cap rate of 8.5 percent over the past year.
- **Single-Tenant:** Net leased assets traded at an average price near $310 per square foot and cap rate of 6.5 percent.

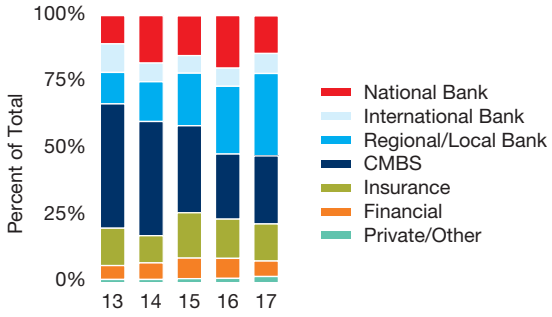
Outlook: Residential development in the southern portion of the metro could attract additional buyer interest this year. Retail properties typically trade 25 to 50 basis points higher here than in northern submarkets.



* Trailing 12 months through 1Q18 over previous time period
Pricing trend sources: CoStar Group, Inc.; Real Capital Analytics

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

Retail Mortgage Originations by Lender



* Through May 1st
Sources: CoStar Group, Inc.; Real Capital Analytics

CAPITAL MARKETS

By WILLIAM E. HUGHES, Senior Vice President, Marcus & Millichap Capital Corporation

Fed raises benchmark interest rate, plans additional increases. The Federal Reserve increased the federal funds rate by 25 basis points in late March, raising the overnight lending rate to 1.5 percent. While the Fed noted the inflation outlook moderated recently, an upgraded economic forecast including tax cuts and a regulation rollback strengthened growth projections through 2020. As a result, the Fed has guided toward at least two more rate hikes this year, while setting the stage for up to four increases in 2019.

Lending costs rise alongside Fed rate increase. As the Federal Reserve lifts interest rates, lenders will face a rising cost of capital, which may lead to higher lending rates for investors. However, greater competition for loan demand has prompted some lenders to absorb some cost increases. While higher borrowing costs may prompt buyers to seek higher cap rates, the positive economic outlook should boost rent growth above inflation over the coming year.

The capital markets environment remains highly competitive. While the Federal Reserve has committed to tightening policy, other major central banks have maintained easing policies. The downward pressure on rates from foreign central banks is counteracting greater economic growth and wider government deficits, keeping demand for fixed-income investments stable. Loan pricing resides in the mid-4 percent range with maximum leverage of 70 percent. Portfolio lenders will require loan-to-value ratios closer to 65 percent with interest rates, depending on term, in the high-3 to mid-4 percent range. The passage of tax reform and rising fiscal stimulus will keep the U.S. economy growing strongly this year, while limited new construction and steady absorption will contain retail vacancy near 5 percent.

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

Marcus & Millichap

Retail Research
Market Report

Third Quarter 2017

San Antonio Metro Area

Lull in Construction, Steady Rent Growth Stoke Buyer Competition

Strengthening local economy spurs demand for more shopping options. Retail space demand is on the rise across San Antonio as construction slows and vacancy reaches a new low. Employers have added more than 80,000 workers to payrolls over the last three years, many in higher-paying white-collar roles, contributing to retail sales that outpaced the nation at midyear. Rising employment numbers are spurring steady household growth as more than 15,000 households are anticipated to be formed this year. Retailers are responding to the growing need for good and services by expanding across the metro, bringing more dining options, discounters and grocery stores to the area this year. Much of the new space has already been leased though, driving more leasing activity to existing properties in the future.

Growing population makes the case for retailers to sign new leases. Local grocer HEB is in expansion mode, adding a handful of stores to the area this year and last. Corporate giants Walmart, Starbucks, CVS, Taco Bell and Dollar General are following suit, accounting for a large portion of new construction. The majority of this year's deliveries are rising in the Northwest and North Central submarkets, areas with vast swaths of housing, led by two strip centers along Loop 1604.

Retail 2017 Outlook

680,000 sq. ft. will be completed

Construction:

Deliveries drop to their lowest level in a decade, well below the more than 1.6 million square feet completed last year.

40 basis point decrease in vacancy

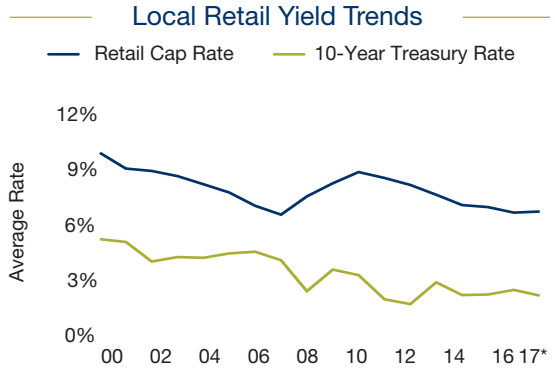
Vacancy:

Net absorption climbs past 1.1 million square feet, bringing vacancy to 4 percent, the tightest reading of the cycle. A 60-basis-point drop was posted in 2016.

2.4% increase in asking rents

Rents:

The average asking rent rises to $16.14 per square foot at year end, marking slower growth than the 3.6 percent pace registered a year ago.



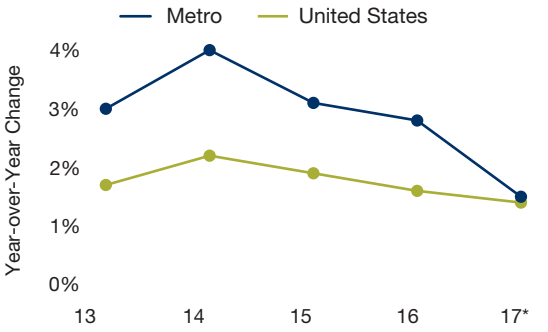
Investment Trends

- A pullback in development and tightening vacancy across the market have the opportunity to strengthen operations for existing assets with vacant space. These types of properties are in high demand from buyers as there is more room for additional value to be created.
- First-year yields in the single-tenant segment trended 10 basis points lower over the past 12 months in comparison with the prior yearlong stretch, settling in the low-6 percent band. For multi-tenant properties, the average cap rate fell in the mid-7 percent territory, also down by 10 basis points.
- Buyers continue to focus on the northern submarkets, following residential growth and driving marketwide sales activity. Assets with long-term leases by national credit tenants can achieve an initial yield in the mid-5 percent territory.

* Cap rates trailing 12 months through 2Q17; 10-year Treasury rate through Aug.
Sources: CoStar Group, Inc.; Real Capital Analytics

2Q17 - 12-MONTH TREND

Employment Trends

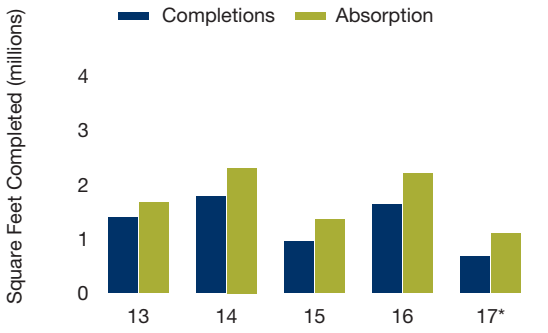


EMPLOYMENT:

2.4% increase in total employment Y-O-Y

- Led by the education and health services sector, which added 9,800 jobs over the year ended in June, the overall workforce grew by 23,900 positions. The professional and business services sector created 5,200 jobs.
- The jobless rate rested at 3.8 percent to end the second quarter, unchanged from a year ago and hovering in the same territory since early 2015.

Completions and Absorption

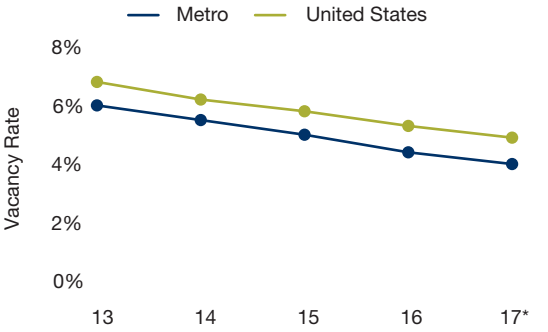


CONSTRUCTION:

1.1 million square feet completed Y-O-Y

- In the second quarter, 193,000 square feet was delivered, bringing completions over the past 12 months below the 1.4 million square feet opened in the prior period.
- Construction was most concentrated in the Northwest submarket where 384,000 square feet of retail space was finished over the past year, led by a 93,500-square-foot HEB-anchored neighborhood center.

Vacancy Rate Trends

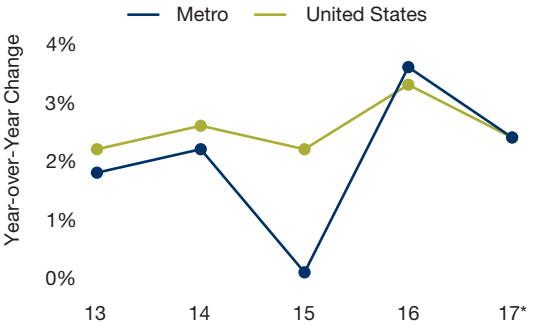


VACANCY:

50 basis point increase in vacancy Y-O-Y

- Net absorption of 550,000 square feet fell behind deliveries, pushing the vacancy rate up to 4.6 percent in June. A 130-basis-point drop occurred last year.
- Vacancy in the single-tenant segment rose 30 basis points year over year in June to 3.9 percent while an 80-basis-point rise was posted for multi-tenant space, climbing to 6.4 percent.

Asking Rent Trends



RENTS:

1.1% increase in the average asking rent Y-O-Y

- The average asking rent increased to $15.32 per square foot at midyear, reversing a 1.5 percent decrease that was registered one year earlier.
- Rent growth was led by multi-tenant properties, which posted a 3.2 percent rate increase to average $15.14 per square foot. Single-tenant asking rent averaged $15.39 per square foot, up 0.4 percent from last year.

* Forecast

DEMOGRAPHIC HIGHLIGHTS

2017 JOB GROWTH*

Metro 1.8%

U.S. Average 1.4%

FIVE-YEAR POPULATION GROWTH**

204,900 or 1.6% Annual Growth

U.S. 0.7% Annual Growth

FIVE-YEAR HOUSEHOLD GROWTH**

90,000 or 2.0% Annual Growth

U.S. 1.1% Annual Growth

2Q17 MEDIAN HOUSEHOLD INCOME

Metro $56,730

U.S. Median $58,672

2017 RETAIL SALES PER MONTH

$4,085 Per Household

U.S. $3,785

$1,481 Per Person

U.S. $1,454

RETAIL SALES FORECAST**

Metro 21.9%

U.S. 21.1%

* Forecast **2017-2022

SUBMARKET TRENDS

Lowest Vacancy Rates 2Q17

Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Asking Rent	Y-O-Y % Change
Atascosa County	2.0%	40	$15.95	40.5%
CBD	2.1%	-10	$18.64	-18.2%
South	3.4%	100	$14.89	31.3%
Guadalupe County	4.0%	130	$10.34	-37.0%
Comal County	4.2%	40	$17.30	-0.3%
Northwest	4.6%	30	$13.37	-9.5%
Kendall County	5.1%	340	$16.06	-11.7%
North Central	5.1%	0	$19.23	13.1%
Northeast	6.2%	60	$12.94	1.9%
North Central	9.3%	680	$23.00	0.0%
Overall Metro	**4.6%**	**50**	**$15.32**	**1.1%**

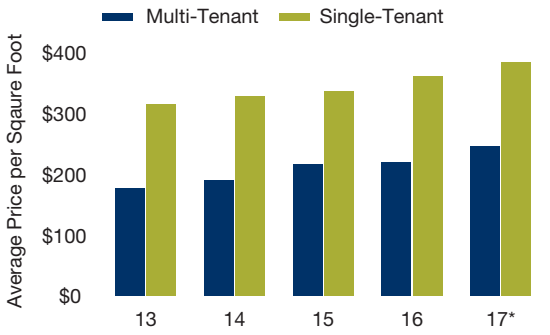
SALES TRENDS

Asset Values Appreciate at Stout Pace as More Buyers Vie for San Antonio Retail Properties

- **Multi-Tenant:** Increased competition pushed the average price up 13 percent to $246 per square foot. Sales activity held stable as buyers were most active in the northern submarkets.
- **Single-Tenant:** Deal flow slowed 3 percent over the past 12 months from the prior period, led by transactions in the Northwest submarket. Prices climbed 10 percent, rising to $383 per square foot.

Outlook: Robust property metrics and favorable demographic trends will keep investment activity strong this year, particularly near new residential development.

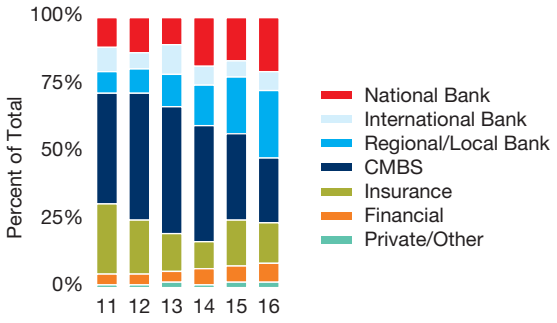
Pricing Trends



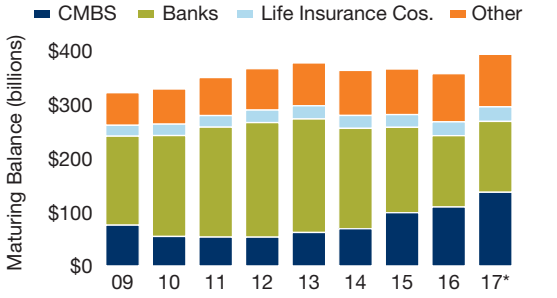
* Trailing 12 months through 2Q17

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

Retail Mortgage Originations by Lender



Estimated Commercial/Multifamily Debt Maturities by Lender Type



* Forecast
Sources: CoStar Group, Inc.; Real Capital Analytics

CAPITAL MARKETS

By WILLIAM E. HUGHES, Senior Vice President, Marcus & Millichap Capital Corporation

- **Monetary policy in transition.** Despite the Fed raising its benchmark short-term rate three times in seven months and signaling another rise before the end of the year, long-term rates have remained stable. The yield on the 10-year U.S. Treasury bond remained in the low- to mid-2 percent range throughout the second quarter of 2017. The Federal Reserve wants to normalize monetary policy and, in addition to rate hikes, will likely start paring its balance sheet.
- **Sound economy a balancing act for Fed.** With unemployment hovering in the low-4 percent range, the lowest level since 2007, the Federal Reserve will remain vigilant regarding a possible rapid increase in inflation if wage growth takes off. Additionally, business confidence and job openings are near all-time highs. Businesses finally have the assurance to expand their footprints after years of tepid growth following the Great Recession. The Fed, however, must now balance economic growth and job creation against wage growth and inflationary pressures.
- **Underwriting discipline persists; ample debt capital remains.** Overall, leverage on acquisition loans has continued to reflect disciplined underwriting, with LTVs typically ranging from 60 percent to 70 percent for most retail properties. At the end of 2016, the combination of increasing rates, conservative lender underwriting and fiscal policy uncertainty encouraged some investor caution that slowed deal flow, a trend that has extended into 2017. A potential easing of regulations on financial institutions, though, could liberate additional lending capacity and nominally higher interest rates may also encourage additional lenders to participate.

National Retail Group

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Marcus & Millichap

Retail Research
Market Report
San Antonio Metro Area

Second Quarter 2017

Bidding Heats Up in San Antonio As Rents Rise and Completions Dip

Residential expansion bolsters retail demand in northwest and CBD. Steady hiring that has outpaced the national rate of growth has stimulated household formation in San Antonio and spurred housing demand. In particular, residential construction in the northwestern portion of San Antonio and the CBD has proliferated during the year ending in the first quarter and retailers have followed to supply residents with a variety of shopping and dining options. In the northwest, developers have accelerated deliveries. Chick-fil-A, Taco Bell, Whataburger and Wal-Mart were constructed during the last 12 months and Starbucks and Lupe Tortilla are underway. In the CBD, construction has been limited and as a result, vacancy plummeted to a tight 2.1 percent as retailers searched for quality space.

Vacancy declines as retail construction moderates. Metrowide, strong space demand has compressed vacancy 240 basis points during the last five years. Tightening will continue into 2017 as net absorption outpaces new supply. Several submarkets will maintain below-average vacancy as retail construction significantly falls from 2016. Additionally, low vacancy will translate to a modest increase in the average asking rent for a second consecutive year.

Retail 2017 Outlook

500,000 square feet will be completed

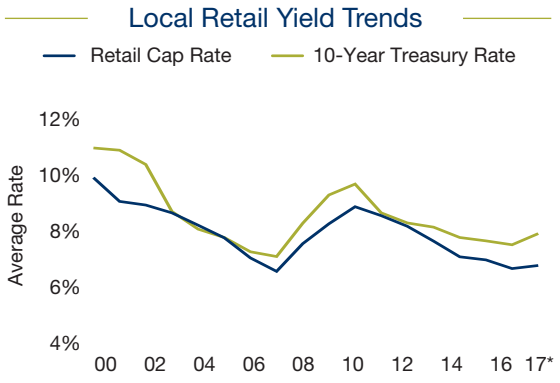
Construction:
Completions dip this year when compared with the 1.6 million square feet of retail space that was delivered in 2016.

70 basis point decrease in vacancy

Vacancy:
Reduced deliveries and healthy demand facilitate a dip in the vacancy rate to 3.7 percent in 2017, matching last year's 70-basis-point decline.

2.4% increase in asking rent

Rents:
The average rent advances above $16.00 per square foot for the first time this year. In 2016, the average increased 2.8 percent.



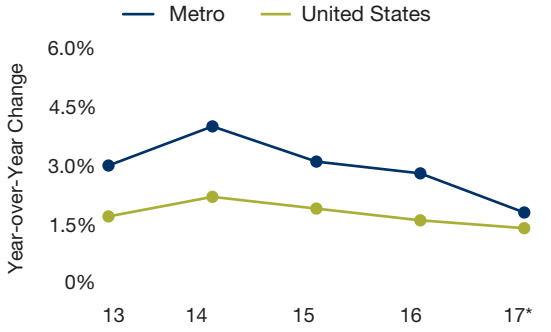
Investment Trends

- Reduced completions will benefit properties with higher vacancy as owners seek to backfill space at market rents. These assets are in high demand as the opportunity to create additional value is attractive to a number of buyers in the metro.
- Pre-leasing is strong for newly built properties coming online this year, boosting demand for existing centers nearby as retailers seek space in growing areas. Assets in the northern portion of the metro are especially popular as healthy demographic trends strengthen the area profile. Retail properties in this portion of the metro typically trade for first-year returns in the 7.0 percent to 8.5 percent range.
- Owners who purchased retail assets in San Antonio during the prior peak will soon be facing the option to refinance or list for sale. A high degree of buyer interest and healthy competition for properties in the metro could help these owners achieve price targets.

* Trailing 12 months through 1Q17
Sources: CoStar Group, Inc.; Real Capital Analytics

1Q17 - 12-MONTH TREND

Employment Trends

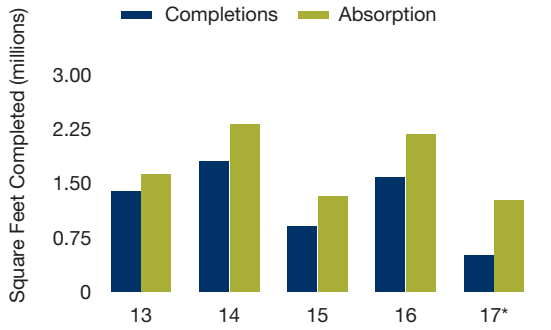


EMPLOYMENT:

2.3% increase in total employment Y-O-Y

- Employers created 3,200 positions during the first quarter of 2017 and added 23,000 workers over the past 12 months. Job additions were led by the education and health services sector, which generated 9,400 jobs.
- The unemployment rate reached a cyclical low during the first quarter of 2016 and increased 30 basis points over the last year to 4.1 percent in March.

Completions and Absorption

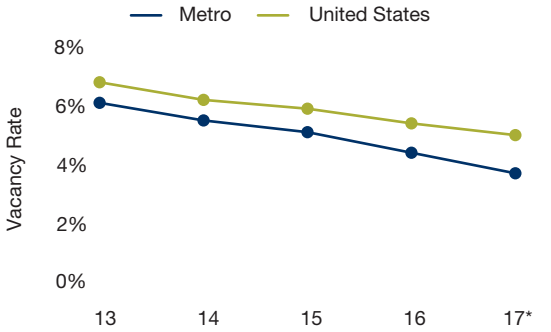


CONSTRUCTION:

1.2 million square feet completed Y-O-Y

- The pace of deliveries is falling so far this year, as merely 20,000 square feet of space was delivered in the first three months of 2017.
- Nearly 620,000 square feet of retail space is underway in San Antonio. Builders are focused on the northwest portion of the metro, and more than 350,000 square feet will be brought online here.

Vacancy Rate Trends

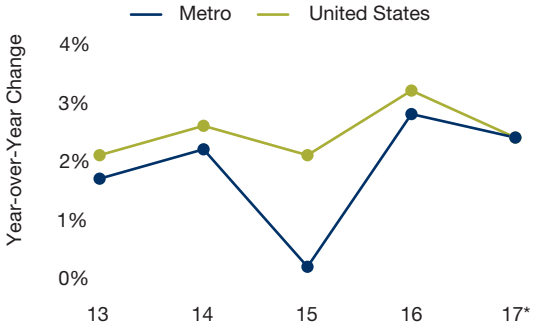


VACANCY:

20 basis point decrease in vacancy Y-O-Y

- The absorption of more than 1.3 million square feet of space over the last 12 months pushed down the vacancy rate to 4.6 percent.
- Deliveries in the CBD have been minimal over the past several years, but redevelopment efforts are attracting new tenants to the area. Over the last four quarters, vacancy in the core compressed 410 basis points.

Asking Rent Trends



RENTS:

4.1% increase in the average asking rent Y-O-Y

- Tight vacancy is generating healthy rent gains, and the average advanced to $15.84 per square foot in March. One year ago, the average slipped 1.0 percent.
- Low vacancy in the CBD is driving rent growth. Here, the average asking rent climbed 4.6 percent to $23.25 per square foot during the last 12 months.

* Forecast

DEMOGRAPHIC HIGHLIGHTS

2017 JOB GROWTH
Metro 1.8%
U.S. Average 1.4%

FIVE-YEAR POPULATION GROWTH*
204,900

FIVE-YEAR HOUSEHOLD GROWTH*
89,000

1Q17 MEDIAN HOUSEHOLD INCOME
Metro $55,568
U.S. Median $58,218

1Q17 RETAIL SALES PER MONTH
$4,085 Per Household
U.S. $3,785
$1,481 Per Person
U.S. $1,454

RETAIL SALES FORECAST*
Metro 21.9%
U.S. 21.1%

*2017-2022

SUBMARKET TRENDS

Lowest Vacancy Rates 1Q17

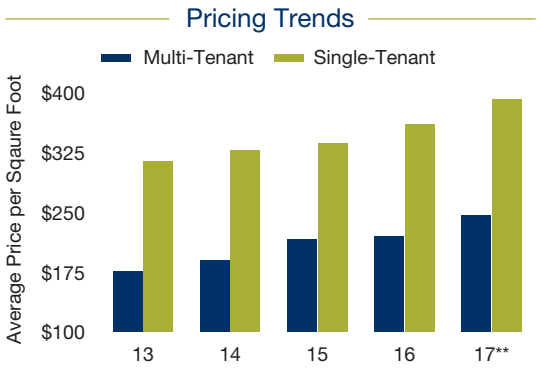
Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Asking Rents	Y-O-Y % Change
Atascosa County	1.2%	-50	$16.60	46.3%
Bandera County	1.6%	-130	$11.48	51.7%
CBD	2.1%	-410	$23.25	4.6%
Kendall County	2.2%	-10	$16.22	-14.9%
Wilson County	3.2%	150	$17.64	5.9%
South	3.3%	-20	$14.65	9.4%
Comal County	4.1%	-130	$19.00	20.3%
Guadalupe County	4.4%	150	$11.91	-26.7%
Northwest	4.7%	60	$14.27	-1.2%
North Central	4.8%	-80	$18.51	7.4%
Overall Metro	**4.6%**	**-20**	**$15.84**	**4.1%**

SALES TRENDS

Prices Rise as Competition Intensifies for San Antonio's Retail Properties

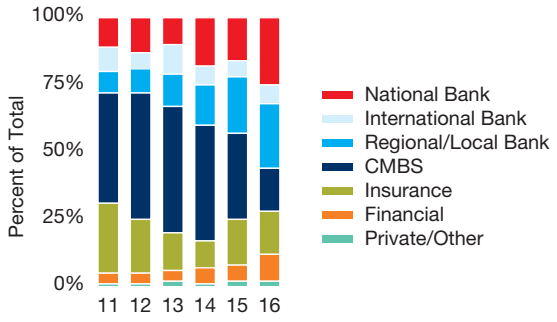
- **Multi-Tenant:** Property sales dipped during the past 12 months, though strong buyer demand translated to a 14 percent increase in the average price to $247 per square foot.
- **Single-Tenant:** Rising interest in single-tenant properties boosted the average price 14 percent to $391 per square foot. Cap rates compressed, with the overall average reaching the low 6-percent band.

Outlook: Vacancy below the national rate and steady rent growth will keep buyers active. Residential development in the CBD and northwest will entice retail investors.

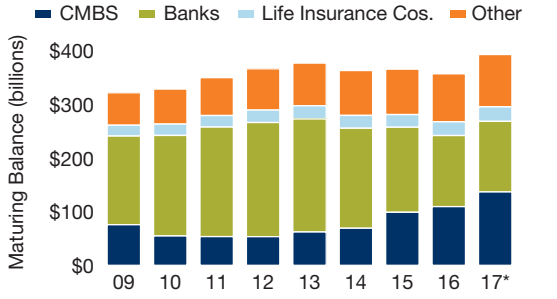


** Trailing 12 months through 1Q17
Pricing trend sources: CoStar Group, Inc.; Real Capital Analytics

Retail Mortgage Originations by Lender



Estimated Commercial/Multifamily Debt Maturities by Lender Type



* Forecast
Sources: CoStar Group, Inc.; Real Capital Analytics

CAPITAL MARKETS

By WILLIAM E. HUGHES, Senior Vice President, Marcus & Millichap Capital Corporation

- **Monetary policy in transition.** The yield on the 10-year U.S. Treasury bond remained in the low- to mid-2 percent range throughout the first quarter of 2017. Despite the Fed raising its benchmark short-term rate twice in recent months and signaling another rise in June, long-term rates have remained stable. The Federal Reserve wants to normalize its monetary policy and, in addition to rate hikes, could start paring its balance sheet. While short- and long-term rates do not always move in tandem, both actions by the Fed have the potential to lift long-term rates.
- **Sound economy a balancing act for Fed.** Tight labor market conditions are finally producing upward pressure on wages and inflation. Unemployment just hit the lowest level since 2007 and consumer confidence sits close to its all-time high. Consumers have the means and the confidence to expand consumption and retail properties stand to gain significantly from increased spending. The Fed must now balance economic growth and job creation against wage growth and inflationary pressures.
- **Lenders exercise disciplined approach.** Overall, leverage on acquisition loans has continued to reflect disciplined underwriting, with LTVs typically ranging from 60 percent to 70 percent for most retail properties. The combination of higher rates and conservative lender underwriting encouraged some investor caution that slowed deal flow in late 2016, a trend that will likely extend into 2017. A potential easing of regulations on financial institutions, though, could liberate additional lending capacity and higher interest rates may also encourage additional lenders to participate.

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.

Marcus & Millichap

Retail Research
Market Report

Third Quarter 2016

San Antonio Metro Area

Vacancy Falls Amid Heightened Retailer Demand

Builders move forward with projects amid tightening conditions. Steady population growth and favorable demographic trends continue to bode well for the San Antonio retail market, and vacancy will squeeze further in the months to come as tenant demand remains robust. Retail deliveries have fallen over the last 18 months, as completions have been mostly limited to build-to-suit and single-tenant space. Wal-Mart and H-E-B have accounted for a large share of completions as they carry out expansion plans, and additional locations are slated for delivery this year. Tightening conditions at area multi-tenant properties, however, are encouraging builders to move forward with sidelined projects. In the second quarter, developers broke ground on Shaenfield Ranch in the western portion of the metro and along the recently expanded loop. The first phase of the project will contain 43,000 square feet of multi-tenant space in addition to a few pad sites. With tenant demand strong and a majority of projects coming online mostly pre-leased, expanding retailers will take space at existing centers, tightening conditions to the lowest level in more than 10 years by the end of 2016.

Buyer interest strengthening as operations improve. Transaction activity has remained relatively stable during the last two years, and deal flow has been limited only by the number of assets available for sale. Buyers are scouring the metro for upside potential, though few opportunities are available as existing owners take advantage of the opportunity to create additional value through building improvements and retenanting vacant space. However, the buyer pool is strong, and those investors who do bring assets to market will be met with a high degree of interest, increasing the chance to meet sales objectives. In the last year, properties in the northern portion of the metro realized significant buyer attention, though the expansion and opening of the outer loop in the northwest and western portions of the metro has brought more attention to these areas in the last 12 months. Cap rates in these submarkets range from 7 to 8.5 percent, depending largely on property location, tenant credit and lease terms. Population and job growth in this area of the metro will continue to encourage retail development and expansion, boding well for investors.

2016 Retail Forecast

2.2% increase in total employment

Employment:

This year, employment in the metro will expand by 2.2 percent from 2015 as 21,500 workers are added to staffs. Area employment advanced 2.7 percent last year when 25,900 jobs were generated.

700,000 sq. ft. will be completed

Construction:

Area developers will complete 700,000 square feet of retail space this year, matching last year's deliveries.

120 basis point decrease in vacancy

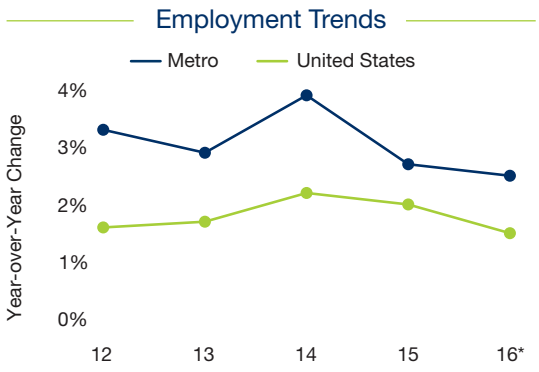
Vacancy:

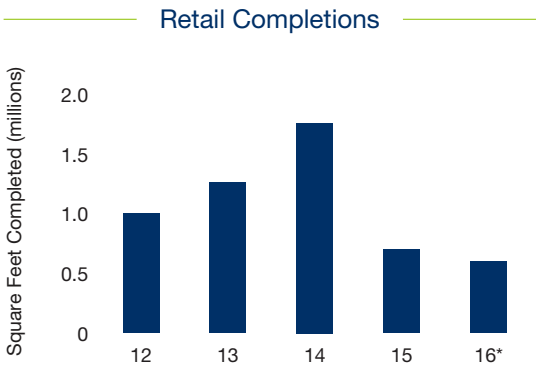
Vacancy will remain tight this year as more than 1.9 million square feet of retail space is absorbed, and the rate will fall to 4.2 percent by the end of this year, down 120 basis points from 2015. Last year, vacancy declined 40 basis points.

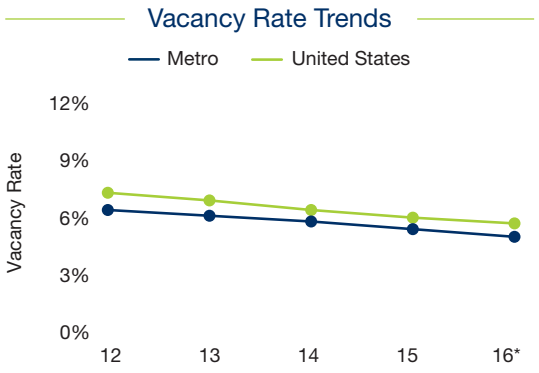
1.4% increase in asking rents

Rents:

Tight conditions will encourage rent growth to resume this year, and the average asking rent will rise 1.4 percent year over year to $15.23 per square foot at year end. In 2015, the average ticked down 0.1 percent.







* Forecast
Source: CoStar Group, Inc.

Economy

- San Antonio employers have added 9,800 positions year to date for an annual headcount expansion of 23,100 jobs, or growth of 2.4 percent year over year. This follows a gain of 29,400 workers in the previous 12-month period.
- Job additions in the last year were led by the leisure and hospitality sector, which created more than 5,200 jobs during the annual time frame. The education and health services sector followed, generating 5,100 positions over the same span.
- Steady job growth over the past few years continues to encourage sound retail sales growth, which advanced 2.6 percent annually in June as metro residents spent more than $42 billion.

Outlook: This year, employment in the metro will expand by 2.2 percent from 2015 as 21,500 workers are added to staffs. Area employment advanced 2.7 percent last year when 25,900 jobs were generated.

Construction

- The completion of approximately 200,000 square feet of retail space in the second quarter brought the 12-month total to nearly 1 million square feet. In the prior annual time period, builders brought 717,000 square feet of space online.
- Wal-Mart continues to expand in the metro, opening its second Supercenter so far this year in the second quarter. The 155,000-square-foot store was delivered in the Boerne Stage Crossing center, following the completion of a 182,000-square-foot location in Guadalupe County during the first quarter.
- The largest project underway in the market is the 119,000-square-foot H-E-B in Comal County. Developers started construction on the grocery store in the third quarter of 2015 and plan to deliver the building later this fall.

Outlook: Area developers will complete 700,000 square feet of retail space this year, matching last year's deliveries.

Vacancy

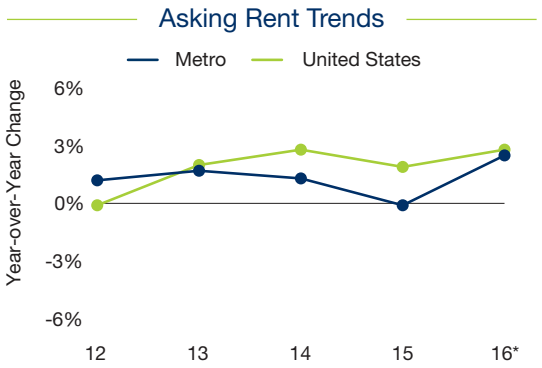
- Property conditions tightened during the second quarter, squeezing 70 basis points to 4.5 percent during the three-month period. This is a 130-basis-point decline from the middle of 2015. The vacancy rate dipped 30 basis points during the prior yearlong period.
- Vacancy in the metro ranged from a low of 1.1 percent in Wilson County to a high of 10.7 percent in Guadalupe County in the second quarter. Just one submarket realized an increase in vacancy over the last 12 months, with the rate rising 10 basis points to 1.6 percent in Atascosa County.
- The average vacancy rate fell 290 basis points over the last four quarters in the CBD to 3.4 percent in June, the strongest decline in the last year. The rate also plummeted 200 basis points in Kendall and Wilson counties, to 1.4 percent and 1.1 percent, respectively.

Outlook: Vacancy will remain tight this year as more than 1.9 million square feet of retail space is absorbed, and the rate will fall to 4.2 percent by the end of this year, down 120 basis points from the end of last year. In 2015, vacancy declined 40 basis points.

Rents

- As vacancy constricts at retail centers along high-traffic routes, space available for lease in the metro is farther from these high-demand areas. As a result, the average asking rent realized a third straight quarter of decline, reaching $14.81 per square foot at the end of June, a 2.6 percent annual dip.
- The average asking rent ranges from a low of $7.59 per square foot in Bandera County to a high of $23.00 per square foot in Medina County. The CBD and Kendall County also recorded above-average rent, reaching $22.73 per square foot and $18.11 per square foot in the second quarter.
- One-third of all submarkets in the metro realized a decline in average asking rent over the last 12 months, with the South San Antonio area recording the steepest drop. Here, the average fell 13.5 percent annually to $12.05 per square foot.

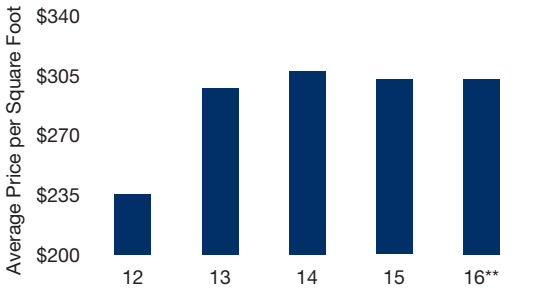
Outlook: Tight conditions will encourage rent growth to resume this year, and the average asking rent will rise 1.4 percent year over year to $15.23 per square foot at year end. In 2015, the average ticked down 0.1 percent.



Single-Tenant Sales Trends**

- Single-tenant transaction velocity dipped 2 percent during the last 12 months as fewer available listing weighed on deal flow. In the previous period, sales grew nearly 8 percent.
- Record pricing continued into June as the average reached $303 per square foot. Nationally recognized fast-food brands and restaurants frequently traded above $400 per square foot during the period.
- Cap rates compressed as low as the mid-4 percent area for some high-demand fast-food establishments. Meanwhile, drugstores traded closer to the mid-5 percent area and dollar stores changed hands approximately 100 basis points higher.

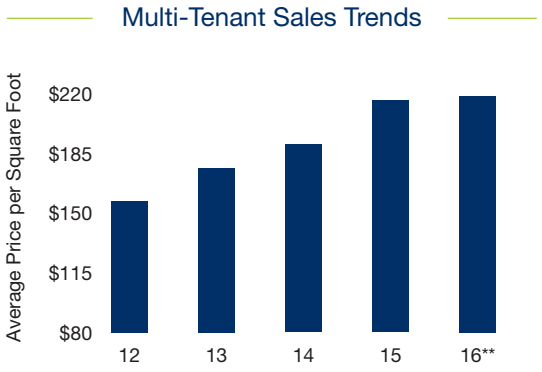
Outlook: Single-tenant investors' interest remains strong, but a limited number of properties available for sale will continue to restrict sales velocity in the months to come. However, a number of fast-food retailers are opening new locations in the metro this year, benefiting single-tenant investors in search of safety plays.



Multi-Tenant Sales Trends**

- Multi-tenant retail property sales remained limited over the last 12 months as owners are reluctant to bring assets to market as improving property operations continue to boost NOIs.
- Increased competition for retail assets lifted the average price over the last four quarters to $219 per square foot. As vacancy tightens and rent growth resumes, NOI growth will continue to appreciate area property prices.
- Multi-tenant property cap rates averaged in the mid-7 percent area over the last four quarters. Initial yields for shopping centers in the norther portion of the metro are capturing significant interest and typically trade in the low-7 percent area.

Outlook: Some owners who purchased assets during the prior peak will soon be faced with the decision to refinance or sell retail properties. Those who choose to list will be met with strong buyer interest and may chase yield in tertiary markets for reinvestment opportunities.



* Forecast
** Trailing 12-month period through 2Q
Source: CoStar Group, Inc.

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Price: $250

Capital Markets

By WILLIAM E. HUGHES, Senior Vice President | Marcus & Millichap Capital Corporation

- Global capital markets have remained stable over the past few weeks, even as Brexit and the continued devaluation of the Chinese yuan have induced bouts of volatility into stock and bond markets. Meanwhile, U.S. economic data has proved resilient, with increases in retail sales and steady hiring supporting a measured pace of growth. Additionally, higher bond prices have lowered prospective yields, boosting the appeal of commercial real estate.
- As the current economic cycle has continued, retail vacancy descended to 5.8 percent by the end of the second quarter. A focus on net-leased construction for pre-leased tenants and mixed-use developments has limited development activity in relation to prior cycles, supporting robust increases in average asking rents. Builders will deliver 46 million square feet of retail space this year, with more than two-thirds of new supply slated as single-tenant structures. This environment will sponsor a fourth straight year of average asking rent growth, with advancement projected to exceed inflation over the same period.
- Capital markets remain highly competitive, with a broad assortment of fixed-rate products available through commercial banks, life-insurance companies and CMBS lenders. Loans are generally offered at terms up to 10 years at maximum leverage of 65 to 75 percent. For 10-year terms, rates will typically reside in the high-3 to mid-4 percent range, depending on leverage and underwriting criteria. Floating bridge loans and financing for repositionings are typically underwritten with LTVs above 80 percent, while pricing at 300 basis points above Libor for recourse deals and extending to 470 basis points above Libor for non-recourse transactions.

Local Highlights

- Denver-based Natural Grocers opened its first San Antonio-area location in the second quarter. The 15,000-square-foot store was opened on NW Military Highway and a second location is already underway on New Braunfels Avenue.
- Several fast-food retailers are opening new locations in the metro, including Chick-fil-A, In-N-Out, Popeye's, Taco Bell, Whataburger and Raising Cane's. The completion of these properties could bring new opportunities for single-tenant retail investors.
- The expansion of Loop 1604 in the Northwest portion of the metro opened in the second quarter. Three overpasses have been opened for travelers to bypass traffic lights at the intersections of Braun Road, New Guilbeau and Shaenfield Road.
- The former Joske's building in downtown San Antonio reopened as the Shops at Rivercenter in the first quarter after a three-year, multimillion-dollar renovation. Fifty stores and a restaruant will call the new shopping center home, with retailers such as Macy's, H&M, U.S. Polo Assn., among many others, opening new locations here.
- H-E-B plans to open two locations in the metro during 2017. One store is planned in the growing western side of the market, near the intersection of Alamo Ranch Parkway and Alamo Parkway, while the second will be in the northeast, near Loop 1604 and Bulverde Road.

Marcus & Millichap

Retail Research
Market Report

Second Quarter 2016

San Antonio Metro Area

Vacancy Falls as Needs-Based Retailers Take Space in San Antonio

Necessities-based retailers expand amid strong migration trends. Retail vacancy will reach a new low in San Antonio in the coming months as tenant demand remains heightened and construction stays limited. Steady hiring is attracting thousands of individuals to the metro each year, prompting the expansion of several necessities-based retailers throughout the region. Wal-Mart, H-E-B, Natural Grocers and CVS will add new locations this year and have more stores planned for the metro. In addition, multi-tenant space underway is, as a result of the robust pre-leasing efforts, coming online mostly stabilized, drawing a wide range of national-credit tenants such as Hobby Lobby and PetSmart. Large blocks of space left vacant by big-box chains trimming locations in recent quarters are also seeing activity. At Home, a regional home-goods retailer, has leased a portion of space formerly occupied by Target in the northern area of the metro. The new location will be the company's fourth in the region and will open in early 2017. This year, deliveries will remain well below the previous five-year average, and strong lease commitments for space scheduled to come online will push vacancy close to 5 percent.

Investor demand intensifies as housing development picks up. Strengthening property operations are encouraging investment in San Antonio retail assets and intensified investor demand will persist through the remainder of this year. Sales activity for multi-tenant buildings in the area surged over the last 12 months as larger funds and out-of-state investors grew the buyer pool. Properties located in the northern portion of the metro are capturing significant interest as developers and retailers follow the path of residential growth, and cap rates for shopping centers in this portion of the metro are in the low-7 percent area. A climb in residential building in southern submarkets will spur demand for necessities-based retailers nearby and investors in search of upside potential will seek retail assets near newly developed or under-construction housing projects. These properties will be ripe for repositioning through capital infusions and bringing rents up to market rate.

2016 Retail Forecast

2.5% increase in total employment

Employment:

The employment base will grow 2.5 percent in San Antonio this year as 25,000 jobs are created. Strong gains will continue in the area's healthcare, trade and hospitality industries. In 2015, nearly 26,000 positions were created, an annual expansion of 2.7 percent.

600,000 sq. ft. will be completed

Construction:

Developers will complete 600,000 square feet of retail space this year, expanding stock 0.6 percent. The majority of space scheduled for delivery this year is in multi-tenant buildings. Last year, builders added more than 560,000 square feet of space to inventory.

40 basis point decrease in vacancy

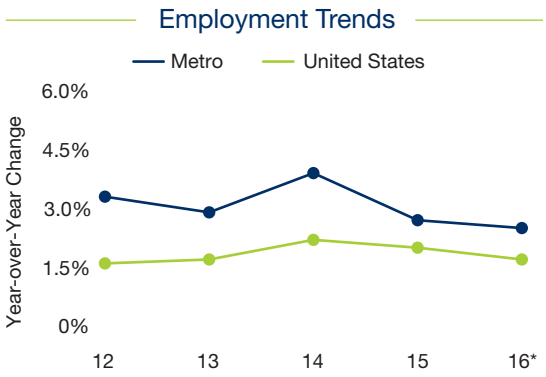
Vacancy:

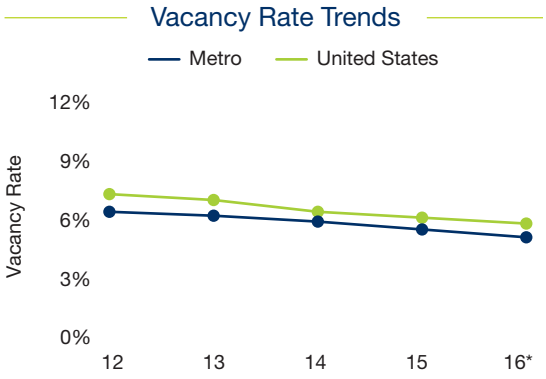
Vacancy will constrict 40 basis points annually to 5.1 percent by year-end 2016 on net absorption of more than 975,000 square feet. This matches last year's decline of 40 basis points when retailers absorbed nearly 930,000 square feet of space.

2.5% increase in asking rents

Rents:

As demand for retail space in the metro remains heightened, rent for marketed space will rise, inching up 2.5 percent from the end of 2015 to $15.31 per square foot. Last year, the average rent dipped 0.6 percent.





* Forecast

Economy

- San Antonio employers added 8,300 positions during the first three months of the year, for an annual expansion of 27,000 workers, or a 2.8 percent rise in the employment base. Last year, the private and public sectors increased employment 3.7 percent annually with the creation of 34,800 positions.
- The education and health services; trade, transportation, and utilities; and leisure and hospitality industries led job gains during the last 12 months, generating more than 5,600 positions each.
- Retail sales continue to rise in the metro, though at a slower pace than one year earlier. Over the past four quarters, sales grew 2.6 percent, compared with a 4.5 percent advance in the previous year.

Outlook: The local workforce will grow 2.5 percent in San Antonio this year as 25,000 jobs are created. In 2015, nearly 26,000 positions were generated, an annual expansion of 2.7 percent.

Construction

- Area builders completed approximately 770,000 square feet of retail space during the last four quarters. In the previous annual time frame, developers brought 875,000 square feet of retail space to service.
- The 100,000-square-foot H-E-B located in Sequin in Guadalupe County was the largest project delivered during the last 12 months. Builders broke ground on the project in the first quarter of 2015. A 182,000-square-foot Wal-Mart Supercenter is also planned nearby, with completion scheduled for the beginning of next year.
- Wal-Mart is expanding across the metro, with four additional stores underway and scheduled for delivery in the second quarter. Two Supercenters will come online, adding 115,000 square feet and 155,000 square feet to inventory. The company will also finalize two Neighborhood Markets, comprising nearly 42,000 square feet each.

Outlook: Developers will complete 600,000 square feet of retail space this year, expanding stock 0.6 percent. Last year, builders added more than 560,000 square feet of space to inventory.

Vacancy

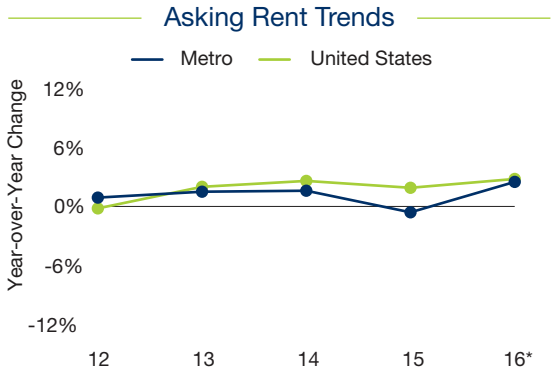
- Net absorption of nearly 1.3 million square feet of retail space over the last 12 months pushed down vacancy 50 basis points to 5.3 percent. The rate also declined 50 basis points in the previous period.
- Three submarkets realized a rise in vacancy during the last four quarters, including the CBD, Comal County and Northeast San Antonio. Increases ranged from 10 basis points in the Northeast to 110 basis points in the CBD. The rate remained unchanged over the year in the North Central San Antonio submarket.
- Vacancy in the metro ranges from a low of 1.6 percent in Wilson County to a high of 10.9 percent in Guadalupe County. Five submarkets boast vacancy below 3 percent, all in outlying areas: Atascosa, Bandera, Kendall, Medina and Wilson counties.

Outlook: Strong pre-leasing for space coming online this year will encourage retailer expansion in existing centers and vacancy will constrict 40 basis points annually to 5.1 percent by year-end 2016. This matches last year's decline of 40 basis points.

Rents

- As space available for rent is farther from high-traffic areas and in older centers, the average asking rent has declined. In the last four quarters, the average fell 1.8 percent to $14.88 per square foot. In the previous annual period, the asking rent rose 2.1 percent.
- Asking rents range from an average of $7.58 per square foot in Bandera County to $23.00 per square foot in Medina County. The largest increase over the last year was posted in Atascosa County, where the average grew 12.2 percent to $11.35 per square foot. Kendall County followed with a rise of 11.1 percent.
- Five submarkets recorded a decline in rents, ranging from 0.4 percent to 5.2 percent over the last year. The average fell in Bandera County, Comal County, North Central, Northwest and South San Antonio.

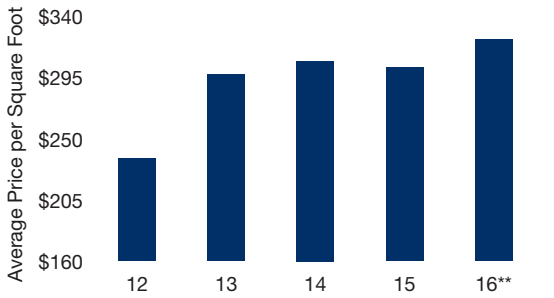
Outlook: As demand for retail space in the metro remains strong, rent for marketed space will rise, inching up 2.5 percent from the end of 2015 to $15.31 per square foot. Last year, the average dipped 0.6 percent.



Single-Tenant Sales Trends**

- Transaction velocity of single-tenant assets fell 7 percent during the last four quarters, though not due to a lack of interested buyers. Sales of restaurant establishments were up during the period, while auto-repair shops and fast-food retailers also accounted for a significant share of trades.
- The average price grew 6 percent over the last 12 months to $323 per square foot. This is still 20 percent below the peak achieved in 2007. National fast-food and restaurant establishments frequently traded at prices above $500 per square foot during the period.
- Single-tenant yields compressed further during the last year, with the average constricting 80 basis points to the low-6 percent area in the first quarter of 2016. Cap rates for fast-food chains started near 4.5 percent for nationally recognized brands.

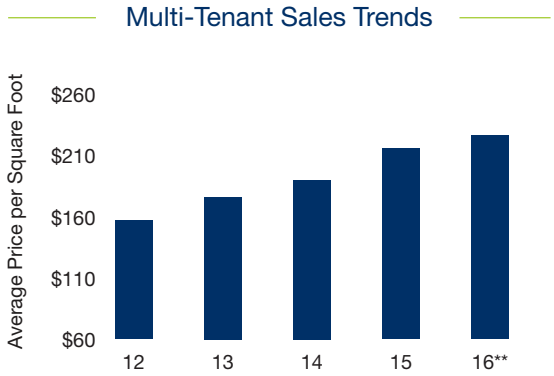
Outlook: Strong economic and demographic trends will attract retailers to expand in the coming months, providing additional investment opportunities as these properties are developed and then sold.



Multi-Tenant Sales Trends**

- Transaction velocity surged 23 percent in the last 12 months as buyers targeted assets in the northern portion of the metro and increased investment activity in Comal County.
- Intense competition for area assets contributed to an 8 percent jump in the average asking price to $226 per square foot. Stabilized centers in high-traffic areas of submarkets to the north of the metro frequently traded above $300 per square foot over the year.
- The average cap rate for multi-tenant property trades over the last 12 months fell 30 basis points to the mid-7 percent area. First-year returns vary widely throughout the metro, largely depending on tenant quality and property location. Newer, stabilized strip centers in the northern portion of the metro traded closer to the mid-6 percent range.

Outlook: Investors will continue to be motivated by improving property operations and retailer expansion plans. Properties in northern submarkets will remain in high demand, though activity will begin to rise in the southern portion of the metro through the year.



* Forecast
** Trailing 12-month period through 1Q
Sources: CoStar Group, Inc.; Real Capital Analytics

National Retail Group

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Capital Markets

By WILLIAM E. HUGHES, Senior Vice President | Marcus & Millichap Capital Corporation

- The U.S. economy grew nominally in the first quarter as respectable consumer trends were partly offset by softness in manufacturing, exports and business investment. The lull in economic activity in the first three months of 2016, and volatility in the stock and debt markets, will likely delay any action on monetary policy by the Federal Reserve until midyear at the earliest. Against this broader economic backdrop, retail properties continued to gain traction behind growing space demand and limited construction. This year, retailers will absorb an additional 61 million square feet of space to cut the U.S. vacancy rate 30 basis points to 5.9 percent.
- CMBS issuance declined in the first quarter from the corresponding period one year ago, offering the latest evidence of disruption in the securitized market. Although spreads on the highest-rated bonds in a securitized pool compressed slightly during this year's opening quarter, they remain wider than one year ago, meaning borrowers face slightly higher costs. Bond investors also require higher returns on loans perceived as being aggressively underwritten with higher LTVs and on loans issued to lower-rated borrowers, putting a squeeze on securitized lenders that could potentially limit lending capacity.
- Bank lenders remain positioned and capitalized to compete for market share, perhaps gaining business that CMBS cannot fill. The Federal Reserve's accommodative monetary stance continues to support a low cost of capital to these lenders. National, regional and local banks offer leverage on retail property loans that averages in the 65 percent range and loan terms vary from five, seven and 10 years. Spreads vary depending on asset location and quality but generally start in the low- to mid-200-basis-point range above corresponding swap rates. Bridge financing spread over short-term benchmarks is also available for properties in transition.

Local Highlights

- Downtown San Antonio has its first grocery store as H-E-B opened a new location late last year. The store is 12,000 square feet and much smaller than its superstore format, providing residents with more of a market feel. A parking lot and gas station are also located on the property, targeting residents working and living in the downtown area.
- Job losses in the natural resources and mining and manufacturing sectors totaled 2,100 positions during the last 12 months. Reductions have had minimal impact as the energy industry is just a small portion of the metro's employment base. A diversified economy has helped keep the unemployment rate relatively stable over the last year, resting at 3.7 percent in the first quarter.
- The Gates of Hill Country Village is a 100,000-square-foot retail center proposed in North Central San Antonio. Builders have secured CVS as a tenant at the project on the corner of Bitters Road and Tower Drive. A grocery store is also planned to anchor the boutique shopping center.
- Hiring in retail trade positions expanded by nearly 3,000 employees during the last 12 months and now makes up 11 percent of the total employment base.