

ChainLinks Retail Advisors / U.S. National Retail Report



Chainlinks is proud to present the inaugural edition of our U.S. National Retail Report. This report covers vacancy, absorption, construction and rental rate trends for the shopping center markets in over 40 major U.S. metropolitan regions. We also track investment trends across the country for multiple product types. We track retailer demand from the local to national levels. We also track the big picture trends that impact the retail industry in general. Our goal is nothing less than to create the industry gold standard for retail commercial real estate research reporting and to that end, we will strive to give you the most in-depth level of analysis and forecasting available in the marketplace.

IN THIS ISSUE

- Power Rankings.....2
- Transactional Trends2
- Marketplace Trends2
- Retailer Trends.....4
- Restaurant Trends.....5
- Economic & Retail Indicators6
- Flat Vacancy Rate Hides Uneven Recovery.....8
- Rental Rate Trends9
- New Construction at Record Lows.....11
- Demand on the Rise - Retailer Growth Requirements Up 40% in 201111
- More Challenges Ahead for Media Retailers.....13
- Grocery Store Consolidation.....13
- M&A Madness.....15
- Foreign Affairs.....17
- Retail Investment Outlook - Trophies, Trash & 'Tweeners.....18
- Triple Net Leased Properties Remain Strong.....18
- 2011: From Bifurcated Market to Trifurcated Market19
- Looking Ahead.....21

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Introduction

With our partners at ChainLinks Retail Advisors, we have compiled the ChainLinks/Terranomics Retail Power Rankings for 2011. These are the retail markets that we deem strongest overall in the nation, based on a wide variety of factors. In putting together these rankings, we look at existing shopping center vacancy, ongoing construction, rental rate trends, and the amount of retailer demand that we are tracking in the marketplace. We also look at overall economic indicators such as unemployment, housing starts, forecast in-migration, and income growth as well as other factors. These rankings are not based on which market will boast the lowest vacancy, the highest levels of occupancy growth, or the strongest rental rate growth. Instead, we are ranking what we see as the general overall health of a marketplace.



For 2011, we see the Washington, D.C., market as leading all other U.S. trade areas in terms of retail health. Retailer demand has skyrocketed there over the past 24 months, current shopping center vacancy levels are low, and unemployment is lower than in any other major market in the country.

Though the San Francisco market currently has unemployment levels above the national average, the city's already tight vacancy levels, high retailer demand, and expected strong job growth in 2011 helped to propel it to number two on our list. New York City, Boston, and San Diego round out our top five—all of which are markets that are forecast for strong employment growth in 2011 and that have lower levels of shopping center vacancy and continued strong retailer interest. The cities of San Jose, Baltimore, Philadelphia, Seattle, and Pittsburgh round out our top ten list.

TOP 10 RETAIL MARKETS

ChainLinks/Terranomics
Retail Power Rankings

Retail's Top Ten Healthiest Markets for 2011

- | | |
|-------------------|-----------------------|
| 1. Washington, DC | 6. San Jose/South Bay |
| 2. San Francisco | 7. Baltimore |
| 3. New York City | 8. Philadelphia |
| 4. Boston | 9. Seattle |
| 5. San Diego | 10. Pittsburgh |

Retail Trends Summary

Before we get into our in-depth analysis, the following are the trends that we see as most crucial to understanding the current retail commercial real estate landscape.

TRANSACTIONAL TRENDS

- In 2009, leasing activity in some markets was off by as much as 70% from what we had seen at the peak (2006/2007) of the last cycle. In 2010, we saw a drastic improvement in those numbers as deal paralysis came to an end, driven by a wave of opportunistic retailers looking to cash in on significantly reduced rents.
- Heading into 2010, rents had dropped from peak-of-the-market values in nearly every major U.S. market by anywhere from 30% to 45%. These numbers have since stabilized, thanks to the wave of opportunistic retailers that upped growth levels to take advantage of once-in-a-generation pricing over the past year.
- Sale activity, which fell off a cliff in 2009, returned in 2010 but was dominated by just a few product types. Trophies versus trash became the rallying cry as the market bifurcated between investors looking to purchase the steady income streams generated by trophy shopping centers with stabilized occupancy from strong national credit tenants (as well as opportunities presented by stable triple net investment properties) and those looking for fire sale pricing on distressed assets and REOs.

MARKETPLACE TRENDS

- The most important trend that we note is that, across the retail spectrum, whether we are talking about retailers, consumers, landlords, tenants, investors, bankers, or appraisers, the general sense is that retail hit bottom in early 2010 and has been in recovery mode since that time.
- Retail vacancies have stabilized in most markets and are now trending downward. However, this trend has not been an even one. In most markets, first-tier centers have already largely recovered and are recording rental rate growth. This is because, with today's diminished pool of expanding retailers, most are looking to first-tier locations first for new stores. In the nation's strongest markets, this growth has spilled over to second-tier shopping centers. But this has not occurred in the nation's more challenged marketplaces. Third-tier centers remain the most challenged.

- While we see location and a number of other factors playing the defining role in whether or not a shopping center ranks as a first-, second-, or third-tier center—and those characteristics go across all shopping center types—there have been some clear-cut winners in terms of overall improvement in 2010. Urban retail, followed by regional malls, typically saw the best improvement in vacancy and rents. Grocery- or drugstore-anchored neighborhood/community centers also performed well—provided that they were first-tier centers within their trade areas. Most first-tier regional and power centers that entered 2010 with vacant big-box or junior-anchor space were successful in backfilling that space last year.
- Unanchored strip centers remain the most challenged shopping center type across all markets. This particularly holds true for those built on the fringes of the pattern of growth at the peak of the last real estate cycle; in many markets, developers followed building permits—not rooftops—and got ahead of the path of development. The real challenge for strip product is that mom-and-pop retailers are typically the bread-and-butter tenant for these projects, and they simply are not back in the marketplace at this time.
- Urban retail posted the most dramatic improvement in 2011. Thanks to quickly increasing vacancy, rents in some markets had dropped 30% to 40% from peak values by late 2009/early 2010. A surge of users looking to break into urban marketplaces and cash in on second-generation deals stabilized the urban marketplace in 2010. Traditional big-box players in particular were active, as players like Wal-Mart and Target inked major downtown deals in markets like Manhattan, Chicago, Washington, D.C., Los Angeles, San Francisco, and Seattle. Rents have since gained traction in most urban markets; in many, those rental discounts of 40% are now closer to 20%.
- The markets where we have seen the greatest surge in retailer demand were either those where unemployment rates were lower than the national average (9.0% as of January 2011) or those with larger population bases and largely built-out retail markets with existing lower levels of vacancy.
- Pop-up, or temporary, stores have become a major phenomenon over the past three years. Toys “R” Us, for example, expanded from 90 holiday pop-up stores in 2009 to 600 in 2010. Meanwhile, other retailers have increasingly used these temporary locations to test new concepts and possible long-term sites. This trend will continue; however, as fundamentals improve, it will become more difficult to find quality space that landlords will be willing to lease on a short-term basis.

It's All About LOCATION & CLASS



Class A Centers...
Improving in ALL U.S. Markets



Class B Centers...
Improving in Strongest U.S. Markets,
Still Struggling in Weakest Markets



Class C Centers...
Still Facing Major Challenges

- Throughout the Great Recession, retailer survival has been based on drastically cutting costs, including renegotiating lease terms with landlords. This trend, with few exceptions, will be over in 2011. This is partly because most tenants who could renegotiate their lease terms have already done so, but gradually improving economic conditions and an increased pool of active tenants in the marketplace will also play a role in ending this trend.
- Early renewals at reduced rates—“blend and extend” deals—will become increasingly rare in 2011. Most tenants who could ink such deals have already done so. In addition, improving retail fundamentals will make most landlords—with the exception of owners of the most challenged properties—less likely to make such offers.
- Retail construction has dropped to its lowest levels in decades. This bodes well for reducing vacancy in most markets. However, in some of the nation’s strongest retail trade areas, we are beginning to see a shortage of quality first-tier space.
- The market will not be without challenges this year. There will be a few major retailer consolidations that will return large blocks of space to the marketplace. However, we expect the number of retailers in expansion mode to account for enough occupancy growth to outpace the amount of space vacated in 2011. Our expectation is that today’s overall vacancy rate of 10.9% will likely drop by at least one full percentage point over the next 12 months.
- Overall asking rate averages will not change much over the next year, but first-tier properties will continue to see

their rents rebounding. Third-tier properties, meanwhile, will continue to struggle and will largely balance out these averages. Properties in the middle will be a mixed bag, depending on local market strength. In all, we expect minimal rental rate growth to occur, and it will be uneven, depending on asset class.

RETAILER TRENDS

- Retail sales are forecast to increase significantly in 2011. Customer Growth Partners, a retail industry think tank, forecasts an annual increase of 5.1%—the largest jump in four years. Standard & Poor's predicts a 3% increase in consumer spending for 2011.

- Retailer expansion is on the rise. We track the annual growth plans of hundreds of major retailers and restaurant chains. As 2010 came to a close, growth plans were up 30% from the levels we recorded the previous year. Following the strong performance during 2010's holiday sales season, many chains further upped growth plans. As this report went to press, the annual growth plans of the retailers that we track had increased to 40% above the previous year's levels. We publish these findings, as well as specific retailer growth plans, in our National Retailer and Restaurant Expansion Guide, a publication that is available exclusively to our clients. (Contact your broker for a copy.)



- Though consumer spending and confidence have both been on the upswing in recent months, we are not done with the "new frugality" by any means. Expect this trend to be with us for at least another four years.
- Look for an increasing bifurcation in retail, with retailers on both ends of the pricing spectrum performing best. The best-of-class luxury retailers are on the upswing, thanks to the gradual return of their core consumers. But necessity and off-price retailers will also continue to dominate. The real challenge will be for retailers in the middle.
- Demographic shifts will continue to be a major determinant of retailer success. Ethnic-themed grocers and retailers will benefit from the United States's growing Hispanic and Asian consumer base. Drugstore chains will benefit from the aging baby boomer generation.
- Social media will continue to play a greater role in retail marketing strategies. Retailers who effectively manage

this medium will see a significant benefit in being able to better target and communicate their message to consumers. However, the growing popularity of sites like Groupon and the explosion of new price-comparison applications for smartphones will increasingly result in a more competitive pricing atmosphere for retailers.



- Grocery store consolidation will be one of the major stories of 2011. Heightened competition throughout 2009 and 2010 drove grocer margins to all-time lows. Though grocery prices are expected to increase in 2011, traditional grocery chains—particularly smaller, unionized players—will continue to be squeezed in the coming year. The influx of nonunionized players like Wal-Mart, Target, drugstores, and convenience stores into the grocery realm means more players grabbing a piece of a shrinking pie. Regional and local chains that are unionized will struggle to compete with pricing. We expect many to close stores and some to go out of business.

- Retailers will continue to increase their expansion focus on international markets. Canada, Mexico, and Brazil will lead the way in the Western Hemisphere. China, India, the Saudi Arabian peninsula, and Eastern Europe will be the focus of significant expansion efforts in the Eastern Hemisphere.

- Store-within-store concepts, such as JCPenney's collaborations with Sephora and Zara, or Sears with Edwin Watts Golf superstores, will continue to be popular and successful ways for retailers not only to monetize existing space within their stores, but to change, upgrade, or reinvent their image.

- Look for more retailers to explore co-branding. Whereas this used to be the domain of restaurant chains (such as Dunkin' Donuts/Baskin- Robbins or the multiple variations of Yum! Brands chains—Taco Bell, KFC, Pizza Hut, A&W, Long John Silver's), look for more traditional retailers to begin to explore this model. Rite Aid and SUPERVALU's discount grocery concept, Save-A-Lot, will be testing 10 co-branded locations in the Carolinas this year in what were formerly larger-footprint Rite Aid stores.

- There continues to be a surge in demand from new grocery players with smaller footprints, ranging from Wal-Mart with its new smaller-format grocery stores to discount, organic, or ethnic-themed chains. These players are aggressively chasing space ranging from 20,000 to 40,000



square feet. Consolidation within the industry, however, will mean that a number of chains with larger footprints in the 50,000 to 70,000 square foot range may be returning space to the market.

- Media retailers will continue to struggle. The 1979 pop song “Video Killed the Radio Star,” by one-hit wonder The Buggles, could have been written to describe retail real estate conditions today. The one-two punch of technological advances and the recession will continue to take a toll on media retailers. Thanks to iTunes, we have already seen the major record store chains go the way of extinction. Streaming and on-demand video are taking out the video rental industry, and Amazon.com is arguably taking out the big-box bookstore. As this report went to press, the bankruptcy of Borders had just been announced, but that being said, we do see bookstores surviving in a bricks-and-clicks world. Chains like Borders and Barnes & Noble are going to have to be very creative, and their site selection processes will become more important than ever. The bookstore industry will be in consolidation mode in 2011, but don’t count booksellers out completely.



- Retailers will continue to experiment with new, generally smaller footprints. In some cases, this will be to reduce costs. In other cases, it will be in the form of traditional big-box users looking to break into urban markets that historically have offered little in the way of premium big-box space. Other players, looking to capitalize on deals for vacant second-generation space, will tweak footprints accordingly.
- Consumers shied away from major purchases throughout the Great Recession. Sales of cars, major appliances, and furniture all dropped precipitously. As the economy gradually improves, look for a spike in the sale of these goods. Auto sales for late 2010/early 2011 have already increased dramatically. Pent-up demand and the limited life expectancies of many of these products will mean that consumers will begin to make up for lost time in 2011.
- Mom-and-pop retailers virtually disappeared during the Great Recession. Their rate of business failure increased, while the pool of new start-ups vanished. Many of these businesses are reliant on home equity or small business loans for their initial line of funding—both of which have largely been off the table over the past three years. We see small-business lending improving in the coming

year—a factor that should help increase the number of active retail start-ups we will see. This process, however, will be slow, and it will be years before we see mom-and-pops in numbers approaching anything close to what we saw at the peak of the last cycle.

- Mom-and-pops will return first and in the greatest numbers in those markets where the housing market remained most stable and where home values dropped least. Because home equity lines of funding are one of the major sources of seed money for these small start-ups, the boom-bust markets in the Western United States and Florida will be the last to see the return of the mom-and-pops.

RESTAURANT TRENDS

- Expansion will continue to be dominated in 2011 by fast-food and fast-casual franchise concepts. Burger concepts, like Five Guys Burgers and Fries and Smashburger, will remain white-hot. The same holds for buffalo wing concepts like Buffalo Wild Wings and Wingstop. Also look for a number of fast-casual Asian concepts to take off in the coming year.
- Frozen yogurt players will also remain active in the coming year. Most of these are also franchise-driven. Self-serve concepts and more upscale chains like Pinkberry and Red Mango will do best. This sector of the market will continue to perform well; the start-up costs are lower than those of most other restaurant options, making these businesses appealing to start-up franchisees.
- Chains like Papa John’s, Quiznos, Subway, and others will continue to offer franchise deals that lower the barrier to entry for new franchisees, further boosting growth levels.
- Casual dining chains will begin to slowly return to the marketplace. Most, like IHOP, Sizzler, TGI Friday’s, and Applebee’s, will pursue franchise-driven growth. But some chains will focus on opening corporate-owned units.
- Fine dining establishments have made it through the worst of it. Look for players like Ruth’s Chris, Morton’s, McCormick & Schmick’s, and other fine dining players to see substantial improvement in 2011 as their core consumers increasingly return to the fold and business spending begins to increase once again.



ECONOMIC INDICATORS

	Population*	2011 Forecast In-Migration*	Total Employment*	Unemploy- ment ***	Personal Income Growth*		Single Family Permits*		Multi- family Permits*	
					2010	2011 (F)	2010	2011 (F)	2010	2011 (F)
Atlanta	5,559,900	58,900	2,269,700	10.3%	2.4%	4.7%	7,000	7,860	1,058	2,547
Austin	1,755,000	31,000	765,600	7.1%	3.9%	6.4%	7,162	9,654	2,012	5,284
Baltimore	2,715,500	8,700	1,265,600	7.8%	2.4%	3.9%	4,078	7,758	1,558	803
Boston	1,932,200	(1,500)	1,081,900	7.4%	3.2%	4.0%	1,100	1,144	1,680	1,009
Charlotte	1,778,800	18,500	810,000	10.8%	4.9%	6.1%	6,625	8,413	1,728	2,800
Chicago	8,057,200	(5,700)	3,573,100	9.0%	2.4%	3.2%	3,212	9,419	2,813	5,608
Cincinnati	2,185,000	2,000	985,600	9.2%	1.8%	2.3%	2,706	4,002	239	1,222
Cleveland	2,088,200	(11,000)	996,000	8.5%	2.5%	1.9%	1,603	1,960	219	412
Dallas/Fort Worth	4,419,200	43,300	2,023,900	8.2%	2.3%	5.9%	11,928	16,927	3,243	5,165
Denver	2,588,900	9,600	1,175,000	8.7%	1.3%	4.0%	5,428	9,402	1,270	2,910
Detroit	1,912,600	(22,200)	681,800	12.0%	1.5%	2.2%	274	210	174	13
Honolulu	911,500	(2,700)	438,600	4.8%	3.3%	2.9%	678	682	884	446
Houston	5,995,400	60,400	2,527,900	8.6%	3.0%	6.1%	24,635	29,464	4,963	5,988
Indianapolis	1,766,600	9,200	866,800	8.7%	1.2%	3.2%	4,322	5,641	1,574	1,280
Inland Empire	4,188,700	(4,500)	1,106,400	14.3%	1.2%	3.0%	6,167	10,040	1,151	1,214
Kansas City	2,089,500	6,800	966,000	9.1%	2.6%	4.1%	1,852	1,834	555	488
Las Vegas	1,921,800	9,700	798,400	14.3%	0.3%	3.7%	5,128	5,442	2,052	2,790
Los Angeles	9,940,800	19,100	3,780,000	12.1%	2.7%	3.2%	2,326	3,134	3,233	3,140
Louisville	1,266,000	3,800	596,500	9.8%	3.7%	5.0%	2,511	4,287	225	714
Miami/Dade County	2,483,500	(16,900)	976,500	12.1%	2.7%	3.4%	1,192	2,959	1,569	5,438
Milwaukee	1,563,500	(4,800)	795,100	7.5%	1.8%	4.1%	583	287	828	183
Minneapolis	3,303,900	6,300	1,693,900	6.5%	2.6%	4.6%	4,332	7,308	1,219	1,584
Nashville	1,608,800	16,200	723,400	8.5%	3.5%	5.5%	4,659	7,578	1,391	1,284
New York City	11,816,100	(23,600)	5,080,300	8.5%	2.9%	3.7%	1,516	2,032	7,461	14,088
North New Jersey	2,132,900	(4,900)	967,200	7.6%	0.8%	1.6%	1,273	1,202	1,087	1,209
Oakland/East Bay	2,559,700	9,200	942,000	10.3%	2.0%	3.8%	1,864	2,384	1,012	1,133
Orange County	3,064,800	10,200	1,365,100	12.1%	1.5%	3.4%	1,604	2,652	921	1,359
Orlando	2,103,400	17,600	1,000,000	11.9%	1.9%	5.2%	4,352	5,886	819	3,098
Philadelphia	4,031,300	200	1,846,300	8.6%	2.1%	3.1%	3,132	3,899	828	760
Phoenix	4,447,500	85,700	1,705,100	8.5%	2.2%	3.9%	9,257	15,853	735	2,600
Pittsburg	2,431,000	N/A	N/A	7.5%	N/A	N/A	N/A	N/A	N/A	N/A
Portland, OR	956,600	27,700	956,600	10.1%	2.1%	4.0%	5,713	10,696	1,041	2,945
Raleigh/Durham	1,161,500	24,500	500,000	8.1%	3.4%	5.5%	6,157	8,131	1,654	3,363
Sacramento	2,158,400	15,900	815,600	12.6%	1.2%	2.9%	2,310	4,136	1,136	1,882
Salt Lake City	1,155,600	9,000	600,200	7.1%	1.4%	4.3%	2,204	2,450	898	992
San Antonio	2,117,700	24,800	830,300	7.5%	4.2%	5.6%	6,215	7,634	1,012	1,370
San Diego	3,088,600	6,500	1,219,500	10.4%	2.5%	3.1%	2,110	2,543	1,208	1,580
San Francisco	1,801,600	6,000	920,700	10.3%	0.3%	2.9%	413	661	680	1,218
San Jose/South Bay	1,859,000	(2,400)	847,700	11.0%	1.9%	3.3%	880	1,315	945	751
Seattle	2,647,600	17,300	1,389,000	9.1%	2.2%	4.9%	5,060	5,913	2,423	3,601
St. Louis	2,866,000	(200)	1,298,300	9.5%	1.5%	4.2%	3,999	5,089	1,084	1,010
Tampa/St. Petersburg	2,765,800	15,300	1,125,000	12.6%	1.7%	5.0%	5,177	9,416	1,471	4,258
Washington, DC	4,333,000	16,600	2,394,900	6.0%	2.3%	3.9%	7,868	9,821	4,371	3,997

*Source: Economy.com **Source: Costar ***Indicates unemployment rate as of November 2010--the latest numbers available as of the time that this report went to press. Source: BLS

****Our Retailer Demand Index is based upon our tracking of current retailer expansion plans and is based upon a scale of 1 to 5, with 5 indicating the highest levels of demand. This is a subjective scale in which the values are comparative against one another, not an objective baseline figure. We extensively track retailer expansion plans and publish them in our National Retailer and Restaurant Expansion Guide reports. These reports are available exclusively to our clients. To obtain a copy, contact your broker.

RETAIL INDICATORS

	Shopping Center Inventory**	Shopping Center Vacancy**	Shopping Center Vacancy Rate**	Shopping Center Vacancy Rate**	Retailer Demand Index****	Total Annual Absorption**	Under Construction**	Average Quoted Rates**	Average Quoted Rates**	Asking Rate Differential
	4Q 10	4Q 10	4Q 09	4Q 10		4Q 10	4Q 10	4Q 09	4Q 10	
Atlanta	138,710,945	20,378,465	14.7%	14.7%	3	(54,815)	0	\$14.67	\$13.49	-8.0%
Austin	26,892,472	2,847,005	11.1%	10.6%	4	23,654	55,775	\$18.77	\$17.87	-4.8%
Baltimore	47,208,672	3,535,990	8.7%	7.5%	4	789,771	38,974	\$18.75	\$18.49	-1.4%
Boston	86,700,002	6,111,195	8.1%	7.0%	5	817,426	142,200	\$15.99	\$15.96	-0.2%
Charlotte	52,102,039	6,203,344	10.4%	11.9%	3	438,261	0	\$12.54	\$13.11	4.5%
Chicago	164,037,087	20,264,696	11.7%	12.4%	3	(605,071)	47,000	\$16.67	\$15.84	-5.0%
Cincinnati	34,382,099	4,916,351	13.4%	14.3%	2	(19,621)	0	\$11.37	\$11.25	-1.1%
Cleveland	50,105,346	6,230,800	12.1%	12.4%	1	(152,797)	16,000	\$11.65	\$11.50	-1.3%
Dallas/Fort Worth	152,706,239	20,047,797	13.0%	13.1%	4	(363,192)	99,084	\$13.96	\$13.01	-6.8%
Denver	69,698,585	7,309,447	10.9%	10.5%	3	495,115	276,856	\$15.05	\$14.37	-4.5%
Detroit	70,427,971	11,370,934	16.2%	16.1%	1	(25,606)	43,177	\$13.10	\$12.41	-5.3%
Honolulu	17,283,886	708,520	4.8%	4.1%	2	120,830	0	N/A	\$32.07	N/A
Houston	149,848,205	15,569,217	12.2%	10.4%	4	2,354,177	73,019	\$15.66	\$14.21	-9.3%
Indianapolis	39,594,538	5,112,962	13.8%	12.9%	2	341,571	0	\$12.30	\$11.88	-3.4%
Inland Empire	83,494,641	9,672,815	11.7%	11.6%	1	284,883	56,666	\$20.92	\$17.87	-14.6%
Kansas City	39,356,156	5,925,364	13.5%	15.1%	2	(1,516)	11,060	\$12.17	\$11.72	-3.7%
Las Vegas	49,809,394	7,662,934	13.8%	15.4%	2	(232,996)	0	\$21.81	\$18.00	-17.5%
Los Angeles	145,448,813	9,974,335	6.4%	6.9%	4	66,385	45,172	\$24.31	\$23.90	-1.7%
Louisville	27,363,887	3,467,952	11.0%	12.7%	2	(528,930)	0	N/A	\$11.19	N/A
Miami/Dade County	44,188,091	2,875,498	7.2%	6.5%	3	370,577	3,700	\$23.18	\$22.09	-4.7%
Milwaukee	33,705,061	3,886,767	11.2%	11.5%	2	272,046	9,140	\$12.71	\$12.32	-3.1%
Minneapolis	53,231,847	5,132,156	9.8%	9.6%	3	426,079	178,000	\$13.67	\$13.82	1.1%
Nashville	29,957,486	1,216,043	11.0%	4.1%	3	206,300	0	\$14.85	\$13.68	-7.9%
New York City	949,808	7,112	0.5%	0.7%	5	(2,437)	0	N/A	N/A	N/A
North New Jersey	91,393,409	7,984,202	8.1%	8.7%	3	(22,583)	167,088	\$19.93	\$19.75	-0.9%
Oakland/East Bay	41,883,907	3,072,361	7.8%	7.3%	3	91,498	39,078	\$24.95	\$22.33	-10.5%
Orange County	63,125,722	4,193,964	6.1%	6.6%	4	(338,551)	15,000	\$24.46	\$23.23	-5.0%
Orlando	63,328,872	7,495,751	11.8%	11.8%	3	(33,393)	202,747	\$16.36	\$15.47	-5.4%
Philadelphia	148,382,644	14,383,979	10.0%	9.7%	4	1,040,827	281,024	\$14.72	\$14.52	-1.4%
Phoenix	103,947,461	15,891,694	13.9%	15.3%	2	(888,440)	145,688	\$16.52	\$15.35	-7.1%
Pittsburg	32,384,401	2,524,171	8.5%	7.8%	4	545,535	6,800	\$11.14	\$11.04	-0.9%
Portland, OR	34,114,022	2,766,275	8.0%	8.1%	2	349,395	226,286	\$18.53	\$18.34	-1.0%
Raleigh/Durham	37,275,676	3,324,942	9.2%	8.9%	3	435,742	283,393	\$16.19	\$15.15	-6.4%
Sacramento	50,165,394	6,911,334	13.6%	13.8%	1	228,736	0	\$19.12	\$17.94	-6.2%
Salt Lake City	41,192,897	3,142,067	9.5%	7.6%	2	669,537	4,000	\$14.72	\$14.42	-2.0%
San Antonio	42,237,522	4,571,863	11.0%	10.8%	4	677,379	451,232	\$14.95	\$14.82	-0.9%
San Diego	54,827,476	4,199,705	7.4%	7.7%	5	120,583	23,179	\$22.39	\$21.42	-4.3%
San Francisco	10,200,710	489,225	4.3%	4.8%	5	51,371	0	\$28.27	\$30.20	6.8%
San Jose/South Bay	31,660,843	2,308,570	6.2%	7.3%	5	(9,397)	29,325	\$26.05	\$27.05	3.8%
Seattle	55,545,652	5,763,344	8.8%	10.4%	3	(583,605)	46,490	\$19.19	\$18.37	-4.3%
St. Louis	52,091,750	5,756,046	11.6%	11.0%	3	488,425	0	\$12.66	\$12.52	-1.1%
Tampa/St. Petersburg	86,671,410	9,572,704	11.0%	11.0%	2	95,420	12,900	\$14.08	\$13.39	-4.9%
Washington, DC	82,139,202	6,114,395	7.6%	7.4%	5	484,816	141,562	\$21.72	\$22.39	3.1%

*Source: Economy.com **Source: Costar ***Indicates unemployment rate as of November 2010--the latest numbers available as of the time that this report went to press. Source: BLS

****Our Retailer Demand Index is based upon our tracking of current retailer expansion plans and is based upon a scale of 1 to 5, with 5 indicating the highest levels of demand. This is a subjective scale in which the values are comparative against one another, not an objective baseline figure. We extensively track retailer expansion plans and publish them in our National Retailer and Restaurant Expansion Guide reports. These reports are available exclusively to our clients. To obtain a copy, contact your broker.

Flat Vacancy Rate Hides Uneven Recovery

We track shopping center vacancy in 43 major U.S. markets. Note that our statistics do not include freestanding retail, urban storefronts, or malls. Across all of the major markets that we track, shopping center vacancy currently stands at 10.7%—the same level as exactly one year ago. There are a number of markets where vacancy has dropped substantially over the past year; Baltimore, Boston, Charlotte, Houston, Nashville, and Salt Lake City have all experienced drops of a percentage point or more. There have also been a number of markets that have seen vacancy levels creep up; Chicago, Cincinnati, Kansas City, Las Vegas, Louisville, Phoenix, and Seattle have all seen increases of a percentage point or more.

Ultimately, however, most markets saw little movement one way or the other. This is not to say that they did not see activity. With national vacancy levels having remained unchanged since the previous year (at today's rate of 10.7%), it would be easy to assume that activity has been flat over the past 12 months, but this simply has not been the case.

Throughout 2010, we saw a surge of big-box leasing activity as well as increased demand from a number of national credit chains. But we also continued to see struggling mom-and-pop retailers go out of business and a number of prominent retail bankruptcies that returned large blocks of space to the market. Two major bankruptcies within the video rental business—that of Blockbuster and Hollywood Video—alone accounted for the closure of nearly 2,000 stores in 2010 and the return of roughly 10 million square feet of space to the market. But the good news is that retailer bankruptcies were actually down substantially in 2010. We tracked only about 20 major bankruptcies over the past year. In 2009, that number stood at 38.

But while players like A&P, Loehmann's, Jennifer Convertibles, Claim Jumper, Charlie Brown's Steakhouse, Blockbuster, and Hollywood Video returned significant blocks of space to the marketplace, a slew of retailers upped their expansion plans and backfilled space. Nowhere was this trend more prominent than in the market for big-box or junior-anchor space—a topic we will be discussing in detail later in this report. Regardless, we saw a surge of activity from discounters, off-price apparel retailers, electronics store chains, and grocery concepts (particularly discount, organic,

and ethnic-themed grocers) that essentially kept occupancy growth positive over the past year. Across all of the markets that we track, the market registered over 8.4 million square feet of occupancy growth over the course of 2010. This was not enough to move the overall national vacancy level, but the market did remain in the black.

Still, these numbers—whether at the national or the local level—do not fully portray what really took place in 2010. What we saw was a year of uneven recovery in which urban properties and those in denser, mature trade areas typically outperformed those in suburban or outlying markets. Most of all, what the market experienced was a set of significantly different circumstances, depending on what class of shopping centers we are discussing.

Retail vacancy is a tricky number to track. Overall vacancy numbers certainly do give an accurate big-picture view of the sector's health, but they don't tell the full story. Unlike office space, which is largely a commodity property type that varies little beyond simple class distinctions from one market to the next, retail centers have a myriad of other variables that come into play.

Breaking down shopping centers by type—malls, power centers, neighborhood centers, strip, etc.—can help, but this has its limitations as well, because the largest single factor impacting vacancy for shopping centers remains location. "Location, location, location" is the old mantra, but the real key to strength in today's marketplace is location, strong anchors, tenant mix, attractive design/architecture and finishes, top-quality property management, and superior leasing teams. That being said, to fully understand what is happening in the retail world, it might be most helpful to divide the market into three tiers.

First-tier properties are those within vibrant urban marketplaces or located at top suburban intersections or on trade corridors. These properties boast successful anchor tenants that help drive traffic to their centers, and they have strong tenant mixes. In nearly every single market that we track—including those markets that currently have the highest overall vacancy levels and the highest overall levels of unemployment—first-tier shopping centers are uniformly posting lower vacancy levels and are currently positioned for rental rate growth, if not already achieving it. With a diminished pool of tenants seeking space, these tier-one centers are seeing the most touring activity and the most deals.



THE MAJOR RETAIL BANKRUPTCIES OF 2010

A&P	Rock & Republic
Loehmann's	Tello's
Blockbuster	Swoozie's
Oriental Trading Co..	Movie Gallery
Gracious Home	Southern Golf Partners
Jennifer Convertibles	Bernie's Audio Video TV Appliance
Controladora Comercial Mexicana, S.A.B de. C.V.	ERT Sales of Hawaii
Riviera Holdings Corp.	CB Holding Corp. (Charlie Brown's Steakhouse/ Bugaboo Creek Steak House)
Planet Organic	
Gems TV	Claim Jumper

Second-tier centers can be situated within vibrant urban marketplaces or even located at top suburban intersections or on trade corridors, but if so, they are lacking in terms of either strong anchor tenants or tenant mix. More often, however, in built-out markets they are in secondary locations—not “on the main drag,” but around the corner. They tend to be near the action, but not in it. They also can be in primary locations in small trade areas, such as being the only supermarket-anchored shopping center in a small bedroom community. In the stronger-performing markets that we track (typically those with vacancy levels below the 8.0% mark, such as Washington, D.C.; Boston; San Francisco; San Diego; San Jose; etc.), these centers are seeing spillover of deals from the region’s first-tier centers, but they still have had to be much more competitive with their rents to land tenants. Vacancy for these centers remains elevated, but it is improving. However, even in the stronger markets, rental rate growth has largely not happened yet, though many (not all) will be in position to post modest growth by later in 2011.

In those markets where vacancy has ranged between 8.0% and 12.0%, the performance of second-tier shopping centers has been mixed. This would include markets such as Austin, Charlotte, Denver, Milwaukee, Minneapolis, North New Jersey, Orlando, Philadelphia, Portland, Raleigh, Seattle, St. Louis and Tampa. For the most part, second-tier centers are seeing some improvement in terms of vacancy in these markets and some stabilization of rental rates. But the improvement has not been across the board or even.

Second-tier centers in the nation’s weaker markets (those where shopping center vacancy currently stands above the 12% mark, such as Atlanta, Chicago, Cincinnati, Cleveland, Detroit, Indianapolis, Kansas City, Las Vegas, Louisville, Phoenix, and Sacramento) are not yet seeing much in the way of deals carrying over from first-tier properties, though this trend will increasingly take place in 2011. Downward pressure remains on rents, though this will ease and begin to stabilize in many trade areas over the coming year. The superior second-tier centers within these markets should begin to see improvement in 2011, though recovery likely won’t take place on the whole for this property type within these trade areas until 2012.

Third-tier centers would be defined as the weakest locations within the urban or suburban core or weaker centers in smaller or rural markets. Unanchored strip retail, with a few exceptions, would largely fall into this category. This category also includes aging shopping centers challenged by obsolescence issues or in dire need of upgrades. With today’s diminished pool of tenants, few are even touring third-tier projects. The deals that are being inked at these centers are almost exclusively value driven—usually with mom-and-pop tenants. The lack of small retail start-ups in the marketplace is having a particularly profound impact on these shopping centers. In every market that we track, whether overall vacancy is low or high, these are the most challenged properties. They almost uniformly boast the highest vacancy levels. Rents are still under downward pressure, and for these landlords 2011 is less likely to be a year of recovery than one of stabilization.

Rental Rate Trends

It is no secret that retail rents have been hammered throughout the Great Recession. In most major markets, the declines in rents—when compared with peak pricing in 2006/2007—have been anywhere from 30% to 50%. We closed out the last real estate cycle with shopping center vacancy rates in the 6% range. By the close of 2009, this number had roughly doubled, to the 12% range.



- ▶ *Inline leasing activity remains a challenge due to the still missing “mom-and-pop” sector. Much of the leasing activity of smaller shop space in 2010 was driven by fast-casual restaurant chains. Panera Bread is one of the bigger success stories of late; the chain is planning to open as many as 100 new units in 2011.*



- ▶ *CVS plans to open between 250 and 275 new drugstores in the United States in 2011 and 2012.*

Both 2008 and 2009 were years of major consolidations within the industry. The collapse of Circuit City alone added about 17.1 million square feet of vacant space to the market. Linens 'n Things's bankruptcy added about 18.2 million square feet of vacancy. Steve and Barry's collapse added another 15.1 million square feet, while Mervyn's liquidation added another 11.1 million square feet. But while these major retail failures garnered most of the headlines, we also saw a surge in consolidations and closures among smaller users—mom-and-pop retailers and national credit tenants alike.

We estimate that from January 2008 through 2010, big-box retailers alone returned 120 million square feet of space to the marketplace. This number is the equivalent of the entire shopping center inventories of Baltimore, Cincinnati, and Kansas City combined. But we also estimate that at least 60 million square feet of in-line space went vacant during this time as well.

All told, we went from a vacancy rate of roughly 6.2% at the end of 2007 to a vacancy rate of 12.8% as of midyear 2009. But the good news is that nearly one-third of the roughly 180 million square feet of space that was vacated during the early days of the recession has now been either backfilled or accounted for. Still, with numbers like these, significant rental rate erosion was inevitable.

Landlords faced challenges on another front as well. With vacancy skyrocketing and many retailers in trouble, most major chains aggressively sought to renegotiate leases midterm. These "blend and extend" deals often resulted in existing rents being cut anywhere from 20% to 50%, and most retailers were successful in pursuing these deals. So rents faced extreme downward pressure on multiple fronts.

The good news is that rents, on the whole, have largely stabilized. The current average asking rent for shopping center space of all types, across all of the major markets that we track, is \$16.85 per square foot (on an annual triple net basis). One year ago, this number stood at \$17.25 per square foot—so we have seen a decline of just over 2%. Yet, just as vacancy numbers may be useful benchmarks but do not tell the full story, the same holds true for broad, sweeping rental rate surveys.

Just as we have seen significant improvement of vacancy in the nation's first-tier shopping centers, mixed results in second-tier centers, and continued challenges for third-tier retail, we have seen the same trends play out for rental rates.

Because first-tier centers continue to see the most retailer activity, are signing the most deals, and have the lowest vacancy rates, they also are experiencing the biggest turnaround in rents. In some of the nation's strongest retail markets, top shopping centers have seen rental rate growth in the 5% to 15% range. But we have seen even modest growth in some of the U.S. markets where vacancy is highest.

Second-tier shopping centers, on the other hand, have been a mixed microcosm of the greater marketplace. Where vacancy levels are tightest, many of these centers have posted modest growth. But in the most challenged markets, this product type has continued to see rents under heavy downward pressure. The good news for these landlords is that most of these centers (including those in markets with vacancy above the 10% range) will see rents stabilize in 2011. Modest rental rate growth will take place for many of the strongest markets in the coming year.

Third-tier retail product, on the other hand, continues to face significant downward pressure on rents regardless of geography. This is not likely to change in the coming year. In fact, an increase in distressed asset sales—which include a large number of these third-tier properties—will likely add more downward pressure to rents. The reason is simple. With new ownership in place and losses already absorbed either by past owners or by lenders, those who do purchase these distressed assets will be in a much better place to lower rents to address occupancy issues.

Looking ahead, expect stronger rental rate growth from first-tier centers; mixed activity from second-tier assets, depending upon local market conditions; and continued rental rate erosion from the sector's weakest properties. Though top properties will see significant improvement in the coming year, our overall benchmark average will tick up only slightly in 2011.



► *Fast-food and fast-casual concepts have surged throughout the recession as consumers have sought more affordable options for dining out. Panda Express has done exceptionally well and has unveiled plans to open as many as 950 new restaurants through 2015. At least 100 new units will come online in 2011.*

New Construction at Record Lows

From 1998 to 2008, the marketplace averaged about 210 million square feet of new retail construction annually. According to the CoStar Group, retail deliveries dropped to 109 million square feet in 2009 as developers emptied pipelines that had been in place long before the recession hit. In 2010, this number dropped to just over 40 million square feet of new deliveries. As of the close of 2010, CoStar was tracking just 25.6 million square feet of retail space under construction throughout the United States. Though 2011 totals will likely tick up somewhat from this level, we don't expect deliveries this year to surpass the 35 million square foot mark. This will make 2011 the slowest year in terms of retail development in over 30 years.



With national vacancy at 10.9%, new construction dropping to a virtual standstill, and retailer requirements up 40% this year, it would appear that we are looking at a formula for rapid decreases in vacancy. Although this is true, the market will not be without some major consolidations this year. On the whole, today's lack of new construction is a positive factor, and we should see overall vacancy rates drop by a full percentage point or more over the course of 2011—even as players like Blockbuster and Borders give back significant blocks of space.

► *Casual dining players are returning to the marketplace and boosting their growth plans for 2011. Denny's plans to open as many as 1,500 of its new Denny's Café concepts over the next decade.*

One challenge to keep in mind, however, is the fact that in many of our nation's strongest performing markets (Washington, D.C.; San Francisco; New York; Boston; San Diego; Houston; etc.) We are hearing complaints from retailers that they are having difficulty finding quality first-tier locations. This trend will only intensify in the coming 24 months. Because of this, we expect developers to increasingly return to the fray in the coming year, albeit with a much more cautious approach than what we saw at the peak of the last cycle.

For example, in the San Francisco Bay region, we are aware of as many as nine new development projects that are coming out of the ground. But in virtually every instance, these projects had pre-leasing commitments in place for 80% or more of their space prior to moving dirt. Likewise, keep in mind that the demand here is for first-tier shopping center space—the first and greatest component of which is location. Redevelopment plays on well-situated but aging second-tier centers are something we expect to see a lot more of over the next 24 months. As development returns to the retail landscape, its focus will be primarily in urban areas or densely populated, mature suburban communities. We are still a few years away from the housing market being positioned for substantial growth again. Until that happens, developers simply won't have any rooftops to follow, and their best bet will be to upgrade existing centers in strong trade areas to meet the Class A criteria of those retailers who are in growth mode.

Demand on the Rise: Retailer Growth Requirements Up 40% in 2011

If there is one common thread that we are seeing across the retail landscape in 2011, it is the return of optimism. In the immediate aftermath of the near-financial collapse of late 2008, most U.S. businesses went into survival mode. As the full impact of the Great Recession hit us, retailers first reacted by consolidating. In 2009, retailer expansion was largely put on hold. Chains closed their underperforming locations, cut capital expenditure budgets, and trimmed budgets to the bone. From 2007 to 2009, shopping center vacancy in the United States went from the 6% range to the 12% range. Meanwhile, most retailers successfully renegotiated lower rates on their existing leases as real estate values dropped by anywhere from 30% to 50%, depending upon the market.

2010 Major Shopping Center Deals			
Shopping Center	Market	Retailer	Total SF
Oak Park Mall	Kansas City	Frontier Furniture	219,000
Westfield Wheaton	Washington, D.C.	Costco	148,000
Village at Westfield Topanga	Los Angeles	Costco	146,000
Deerbrook Mall	Chicago	Wonder Warehouse	136,000
Tri-County Commons	Cincinnati	Home Emporium	125,000
Eastland Center	Detroit	Shopper's World	112,000
Covina Town Square	Los Angeles	Lowe's	111,000
Meridian Retail Center	Chicago	Garden Ridge	110,000
Harrison Square	Raleigh	Carolina Pottery	107,000
Antelope Valley Mall	Los Angeles	Macy's	105,000
Staten Island Plaza	New York	Kohl's	101,000
Middlesex Commons	Boston	Market Basket	100,000
Orangethorpe Shopping Center	Orange Co. CA	Wal-Mart	100,000
Lincoln Park South	Raleigh	My Princess Shop	98,000
North Versailles Town Center	Pittsburgh	Goodwill	96,000
Willowchase Shopping Center	Houston	Fiesta Mart	93,000
Santa Rosa Plaza	SF Bay Area	Forever 21	90,000
Winston Plaza Shopping Center	Chicago	Meijer	90,000
Atascocita Commons	Houston	Kohl's	89,000
NewPark Mall	Oakland	Burlington Coat Factory	87,000

By 2010, the deal paralysis that marked much of 2009 was finally gone. A new crop of retailers saw incredible opportunities, with once-in-a-generation real estate pricing (for both leases and sales). Some of the more active players were familiar names like Target, Wal-Mart, Best Buy, T. J. Maxx, Marshalls, and Ross Dress for Less. Others, like Forever 21 and HHGregg, were relative upstarts. And on the grocery front, we saw a whole slew of concepts on the move, ranging from new small-format groceries from Wal-Mart, to discounters like Big Lots!, Grocery Outlet, and Save-A-Lot, to organic chains like Henry's, Sprouts, and Newflower Farmers Markets.

We track the annual growth plans of hundreds of major retailers and restaurant chains. As 2010 came to a close, growth plans were up 30% from the levels we recorded the previous year. Following the strong performance during 2010's holiday sales season, many chains further upped growth plans. As this report went to press, the annual growth plans of the retailers that we track had increased to 40% above the previous year's levels. While many retailers have been boosting their

foreign expansion plans over the past few years (and they will continue to do so), our numbers track expansion plans only within the United States. That being said, the current surge demonstrates to us two key factors: the return of optimism within the retail sector, and the desire to expand quickly now—before retail fundamentals improve enough for rents to begin to climb again.

Nearly every region of the United States should feel a boost; however, the strongest increase in growth plans has generally been in those markets where unemployment is lowest. The greater Washington, D.C., area remains highly desirable, as does the greater Eastern Seaboard from Boston to the Carolinas. We have also seen a considerable increase in retailer requirements in the Chicago market. Texas remains extremely popular. And though both have elevated unemployment, Florida and California have also seen a spike in retailer demand in most markets. Regardless, numbers are up across the board, whether in the Pacific Northwest or the Gulf Coast states.

Among the most

ACTIVE RETAILERS

- **7-Eleven** is hoping to open as many as 350 stores in the U.S. and Canada this year.
- **99¢ Only** is planning on at least 25 new units.
- **Apple** will add at least 50 new stores in 2011.
- **AT&T** - expects to add at least 100 new cellular stores this year.
- **Bottom Dollar Food** could add as many as 110 stores in 2011.
- **Burlington Coat Factory** is planning on at least 20 new stores.
- **Chico's** could add as many as 40 units in the next 18 months.
- **Citi Trends** may open as many as 65 new stores this year.
- **CVS** will open as many as 275 stores this year.
- **Dick's Sporting Goods** could see as many as 40 new stores this year.
- **Dollar General** plans on 625 new stores in 2011.
- **Family Dollar** has 300 stores on tap for 2011.
- **Forever 21** could be looking at as many as 50 new stores this year.
- **Fresh & Easy** could open as many as 60 stores this year.
- **HHGregg** could be opening as many as 60 stores this year.
- **Jo-Ann Stores** could open as many as 50 units in the next 12 months.
- **Pep Boys** may open as many as 55 new stores.
- **Ross Dress for Less/dd's Discounts** are likely to open 60 stores this year.
- **Tractor Supply** has plans for as many as 75 units in 2011.
- **ULTA** has 60 stores planned this year.
- **Verizon Wireless** should add at least 125 stores.
- **Wal-Mart** could be adding as many as 400 stores throughout North America over the next 30 months.

Among the most

ACTIVE RESTAURANTS CHAINS

- **Auntie Anne's** is looking to add at least 50 units this year.
- **Baskin-Robbins** is looking at opening at least 60 standalone and 100 co-branded units.
- **Buffalo Wild Wings** should hit the 100-new-units mark this year.
- **Checkers/Rally's** has plans for as many as 125 units.
- **Chick-fil-A** should hit the 80 new unit mark this year.
- **Chipotle** will open as many as 130 new stores this year.
- **Cold Stone Creamery** would like to top 100 new units in 2011.
- **Denny's** will be opening at least 111 new restaurants this year.
- **Dunkin Donuts** could see as many as 350 new units this year.
- **Five Guys Burgers and Fries** should top 200 new stores in 2011.
- **IHOP** will open between 50 and 70 new units in 2011.
- **Little Caesars** will open at least 100 new stores this year.
- **Panda Express** will open a minimum of 100 stores this year, likely more.
- **Panera Bread** will open about 100 new restaurants this year.
- **Pinkberry** is likely to hit the 100-new-unit count for the coming year.
- **Popeye's** will likely open 130 new restaurants this year.
- **Red Mango** is likely to open 100 new units this year.
- **Smashburger** is likely to open at least 100 new restaurants in 2011.
- **SONIC** would like to open as many as 85 units this year.
- **Starbucks** will open 100 new US stores this year.
- **Wingstop** will open as many as 90 new units in 2011.

More Challenges Ahead for Media Retailers

While retailer expansion plans are up by 40% from what we tracked the previous year, the market is not without some challenges ahead. Media retailers have been particularly hard-hit by the one-two punch of technological advancements and the worst economic downturn in 70 years.

As this report went to press, Ann Arbor-based bookstore giant Borders had just filed for Chapter 11 bankruptcy protection. The chain has announced plans to close roughly one-third of its remaining stores, or about 275 units. With an average footprint of 30,000 square feet, this equates to over 8.2 million square feet of space that will be returned to the marketplace by late April 2011.

The real question may be whether there will be additional rounds of store closures as Borders goes through the bankruptcy process. While we do expect the chain to emerge from these proceedings, we also would not be surprised to see Borders sold to new ownership. A post-bankruptcy Borders could be an attractive target for private equity.

Meanwhile, there still remains speculation that a buyout from Barnes & Noble or some sort of joint buyout of both firms could happen (investor William Ackman tried to put together such a deal just a few months back). Certainly, any sort of Borders/Barnes & Noble merger would almost assuredly mean the closure of even more stores, as this new entity would go about cutting redundant locations.

If there is any good news, it is that Borders's typical template of 30,000 to 40,000 square feet is the sweet spot for many expanding big-box space users—such as HHGregg, which this week announced plans to open as many as 45 new stores through the end of next year.

Meanwhile, the market continues to deal with the fallout from Blockbuster's ongoing bankruptcy proceedings. Blockbuster closed about 960 stores in 2010 and is likely to close as many as another 1,000 stores this year, assuming that it emerges from bankruptcy. A recent petition from creditors has sought to amend Blockbuster's filing from Chapter 11 reorganization to Chapter 7 liquidation, though it is unclear if this will take place. Most analysts believe it unlikely to succeed, as Blockbuster is believed to have a viable future as a post-bricks-and-mortar company if it can get out from

under its debt. Still, complete liquidation would mean that as many as 3,000 remaining locations would be shuttered. With an average footprint of 5,000 square feet, that would equate to 15 million square feet of space being returned to the marketplace.

Grocery Store Consolidation

Throughout the recession, retailers have looked for ways to respond to the new frugality that took hold of consumers, who became increasingly price-conscious and focused on purchasing only necessities. So it should come as no surprise that multiple players have made moves to expand their presence in the grocery arena.

Among the players getting into the grocery game are dollar stores. Dollar General opened roughly 600 stores throughout the United States in 2010. In 2011, this number should reach 625 stores. The chain is increasingly looking to the West Coast and New England for growth opportunities (their typical floor plan is about 9,000 square feet). But in addition to aggressive expansion, the chain is exploring beefing up its limited selection of groceries.

Family Dollar is pursuing a similar strategy, but with about 300 new stores planned for 2011—including new locations in California. The same holds true for Dollar Tree stores. Dollar Tree plans to open about 275 new locations in 2011. Dollar Tree's typical footprint runs 8,000 to 12,000 square feet; however, this year the company will be launching a new concept, Dollar Tree Market. This new concept will feature an expanded selection of groceries and will require spaces of at least 23,000 square feet. Dollar Tree will also be adding more groceries to its traditional concept, as well as its smaller format Deal\$ stores.

But dollar stores are not the only ones beefing up grocery selections. 7-Eleven, which is aggressively growing in California, Texas, and the Northeastern United States, is adding more fresh food and grocery selections in most of its stores. The convenience store giant is planning on at least 350 new stores this year and up to 400 new stores in 2012.

It doesn't end there. Walgreens has been beefing up its selection of fresh foods and groceries in a number of test markets and is reportedly planning on rolling out more groceries across its 7,100+ U.S. locations. Last year the chain hired the former Tesco executive who oversaw the initial launch of Fresh & Easy stores in the Southwestern United States. Among the changes in store are an increased



► *Borders will be closing 275 stores by late April 2011. This equates to over 8.2 million square feet of real estate that will be returned to the marketplace.*

selection of salads, ready-to-bake pizzas, fresh fruits, and pre made sandwiches and meals. Major rival CVS is also reportedly exploring the concept of beefing up its fresh food offerings.

Traditional grocery chains are also facing increased competition from a new crop of organic players. Sprouts Farmers Market, Henry's Farmers Market, and Sunflower Farmers Market have all been expanding at a rapid pace, adding at least 60 new stores among them over the past 18 months, with plans to increase those growth levels going forward. All of these concepts typically seek space in the 20,000 to 30,000 square foot range. The announcement in mid-February of Apollo Management's buyout of Henry's (with plans to merge it with the Sprouts concept) could be a precursor to even more aggressive expansion from the chain.

Discount grocers have also been on a roll. ALDI added roughly 100 stores last year and will do the same this year. ALDI's cousin concept, Trader Joe's, is also in growth mode. Although planned store numbers have not been released, we expect a minimum of 20 new units in 2011 and would not be surprised to see the final number of new stores as high as double that. Trader Joe's typically uses between 10,000 and 20,000 square feet, while ALDI's uses about 20,000 square feet.

Meanwhile, Tesco's Fresh & Easy concept is finally gearing up for its Northern California and Northern Nevada launch. The chain has had deals in place—in some cases going back three years—but was waiting until the economy was right for the launch. We expect as many as 60 openings this year, about two-thirds of which will be in Northern California or the Reno market.

Arguably the biggest game changers, however, are Target and Wal-Mart. Target rolled out its P-Fresh grocery concept a little over a year ago and has since been aggressively adding grocery departments to existing stores. The chain has spent nearly \$1 billion in rolling out this concept and closed 2010 with roughly 400 stores featuring grocery departments.

But the biggest news comes from Wal-Mart. Wal-Mart could be opening as many as 400 new stores throughout the United States and Canada over the next 30 months. While the chain's Supercenter prototype of 125,000 square feet or greater will still be in play, what is most interesting is that Wal-Mart is expanding in a wide array of formats.



► *Wal-Mart is on an expansion blitz. The chain could be opening as many as 400 new stores in a wide variety of footprints over the next 30 months. Wal-Mart's new small-format grocery concept could prove to be a game changer.*

Wal-Mart has been aggressively seeking sites for its new small-format grocery concept. Wal-Mart had tested a 20,000 square foot concept called Marketside in the Phoenix market a few years back when Fresh & Easy initially launched in that trade area. Wal-Mart opened only a few stores, and for some time it seemed like the concept was dead. The retailer is now looking for sites in the 30,000 to 40,000 square foot range for what could be hundreds of small-format groceries in dozens of major U.S. markets.

On the West Coast, the chain has also purchased or leased some space formerly occupied by Mervyns department stores. These spaces typically run about 80,000 square feet, and Wal-Mart is reportedly looking at opening larger-format grocery-only stores at these sites. We have also heard rumors of deals done within urban areas (word on the street is that Wal-Mart has signed one of these in San Diego's Gaslamp District) for stores as small as 10,000 square feet.

These moves coincide with Wal-Mart's attempts to break into a number of major urban markets where it has not traditionally had a presence. Chicago; Washington, D.C.; and New York City are just a few of the trade areas where the chain is planning a mix of new stores in a mix of formats. Meanwhile, our sources in Southern California tell us that they may be working on as many



► *Look for Walgreens to open a minimum of 200 new stores in 2011, though this number could reach as high as 300—not counting any further acquisitions the chain makes. Walgreens is also beefing up its grocery selections.*

as 50 deals just in Los Angeles and Orange County. The San Diego market could see as many as 25 to 30 deals. Double-digit unit growth is also reportedly in the works for a number of other markets, such as Detroit and Sacramento.

The problem, of course, for traditional grocers is not only that competition is increasing from so many players, but that most of these players are not unionized. For smaller grocery chains—the unionized local and regional players—it will be extremely difficult to compete with pricing offered by these nonunionized chains. Wal-Mart, in particular, as the world's largest retailer and now the world's largest grocer, will prove to be nearly impossible to compete with in terms of pricing, thanks to its immense buying power and cheaper labor costs.

The reality is that too many players are competing for a piece of the grocery pie, and industry consolidation is almost certain in 2011. This is one of the major challenges we see facing the retail landscape this year.

Of course, this is not to say that traditional grocery players cannot adopt successful strategies to weather this storm. One strategy that we think will work is being employed by SUPERVALU, which operates numerous regional grocery chains like Albertsons, Jewel-Osco, Lucky, and Shop 'n Save. While SUPERVALU continues to close underperforming locations, it is beefing up expansion of its discount grocery concept, Save-A-Lot. Our sources tell us to expect at least 100 new Save-A-Lot stores in the coming year. These smaller-format grocery stores typically use 15,000 to 20,000 square feet. Save-A-Lot is also experimenting with co-branded stores with Rite Aid, a move that should be beneficial to both.

Besides focusing on discount concepts—beefing up store brands, offering club cards, and other methods—to appeal to price-conscious consumers, it is crucial that grocers don't forget the importance of location. Safeway has employed a strategy of aggressively seeking out premium locations in its markets, an approach that has given it market dominance in trade areas like Northern California. Safeway will be opening at least six new San Francisco Bay Area stores this year and a couple of others in the Los Angeles area.

We also do see some good news for grocers in that consumers, while still frugal, appear to be opening up their wallets somewhat. While discounts may be the call of the day, consumers still value strong customer service—an

area in which the traditional players still have Wal-Mart and other discounters beat. But the reality is that we will see consolidation in the grocery industry this year. In fact, the recent bankruptcies of A&P and Bashas' indicate that this trend is already happening. Most at risk will be smaller regional chains that are unionized and that focus on medium price points. We don't see this trend playing out so much with the higher-end or luxury grocery chains, nor with the discounters.



► *Target is rolling out its P-Fresh grocery concept in all of its new stores and hundreds of its existing locations. Target has announced plans for 21 new stores in 2011.*

What impact will this have on the commercial real estate market? We see a surge of activity from grocery retailers looking for space in the 20,000 to 40,000 square foot range. Meanwhile, we expect consolidation to occur largely among users of traditional larger-grocery formats in the 50,000 to 70,000 square foot range. That being said, we think that occupancy gains will surpass the amount of space that is actually returned to the marketplace. However, the market for junior-anchor space (in the 20,000 to 30,000 square foot range) is already extremely active. Meanwhile, big-box space above the 50,000 square foot level has proven difficult to fill over the last couple of years unless landlords are willing to

spend the money to demise these spaces. Look for grocery store consolidation in 2011 to have minimal impact on overall vacancy levels but a significant impact on pricing for larger box space.

M&A Madness

The atmosphere is ripe for merger and acquisition activity to take off in 2011. The reason is simple: The market is at a crossroads. The general sense of investors is that we have hit bottom and are beginning to see improvement. Meanwhile, the retail landscape is full of players looking for capital infusions.

On one hand, we have retailers in distress. Borders would be a prime example. Borders's sales levels in recent months have, for the most part, mirrored those of their relatively healthy major rival, Barnes & Noble. The problem has been debt. Now that the chain is in bankruptcy, it will be able to write off much of this debt. It will also be able to walk away from leases on stores that were underperforming. Meanwhile, we still have a company with amazing brand recognition, a loyal customer base, a great Internet presence, and some superb real estate. We would not be surprised to see a private equity firm pick up the chain for a fraction of what it would have cost a couple of years ago, with the intention of turning it around. What would this mean for the commercial real estate

market? You can rest assured that the chain would use bankruptcy to get out of leases at underperforming locations, but a new owner with capital could minimize the damage and eventually see Borders returning to health and growth.

But there are opportunities beyond those of retailers in distress. We continue to see new and exciting concepts that need capital. In some cases, these may come from private equity groups. In other cases, they may come from existing major players. For example, in early February, news broke that Darden Restaurants—the operator of Olive Garden, Red Lobster, and a number of other chains—may be in the market to pick up some new dining concepts. Among the names touted were BJ's Brewhouse, California Pizza Kitchen, and the Yard House chains. Speculation was also rife that Darden might sell off its Bahama Breeze concept in the process. Such a move would probably mean rapid expansion for any or all of the acquired chains.

The fact is that we expect M&A activity to skyrocket in 2011 because pricing is low and the options for investors are many. The following is a list of chains that have recently sold, are for sale, are on the selling block, or are speculated by reputable analysts to be available in the marketplace.

M&A Mania

Chains That Have Recently Sold, Are Currently for Sale, or Are Rumored to Be for Sale

Arby's	Currently on the selling block.
A&W Root Beer	Currently on the selling block.
Back Bay Restaurant Group	Tavistock Restaurants purchased in late 2010 for an undisclosed price.
Bahama Breeze	Rumored to be on the selling block.
BJ's Brewhouse	Rumored to be a target of Darden.
BJ's Wholesale Club	Currently on the selling block.
Bojangles' Restaurants	Rumored to be on the selling block.
Blockbuster Video	As of press, Blockbuster was exploring the idea of selling itself to one of its major creditors for as low as \$290 million.
Borders	It is very possible that this firm may become the target of investors as it emerges from bankruptcy.
Bubba Gump Shrimp Company	Sold to Landry's in late 2010 for an undisclosed price.
Build-A-Bear	Rumored to be on the selling block.
California Pizza Kitchen	Rumored to be a target of Darden.
Dollar Giant	Canadian dollar store chain sold to Dollar Tree in late 2010 for \$52 million.
Dots	Sold to Irving Place Capital in late 2010 for an undisclosed price.
Fog Cutter Capital Group	Looking to acquire a major restaurant chain in 2011.
Gordon Biersch Brewery	Sold to Centerbridge Capital Partners in late 2010 for an undisclosed price.
Gymboree	Sold to Bain Partners in late 2010 for \$1.6 billion.
Harry & David's	Needs recapitalization—bankruptcy, acquisition, or both possible.
Henry's Farmers Market	Was acquired by Apollo Management in mid-February for an undisclosed price. Henry's will adopt the Sprouts banner.
Hooters	Sold to Chanticleer Holdings in January 2011 for an undisclosed price.
J. Crew	Acquired by Leonard Green in November 2010 for \$3 billion.
Jo-Ann Fabric	Leonard Green made a \$1.6 billion offer to be voted on by shareholders in late February.
Long John Silver's	Currently on the selling block.
McCormick & Schmick's	In the market for an upscale casual dining concept.
Noodles & Company	Purchased by Catterton Partners in late 2010 for an undisclosed price.
Pick Up Stix	Sold to Lorne Goldberg (owner of Leeann Chin) for an undisclosed price.
Red Robin	Rumored to be an acquisition target.
Rite Aid	Rumors persist that Canadian pharmacy giant Jean Coutu may be in the market to acquire Rite Aid.
Rock Bottom Brewery	Sold to Centerbridge Capital Partners in late 2010 for an undisclosed price.
Yard House	Rumored to be a target of Darden.



Foreign Affairs

Throughout the recession, major retailers have been upping their growth plans for emerging markets. China remains the jewel in the crown, but growth in foreign markets is up across the board, whether in Canada, Mexico, Brazil and the rest of South America, Asia (India ranks a strong second behind China, but don't forget Vietnam, Korea, and Japan), or Eastern Europe. The key here is to tap into new markets where there is emerging wealth and a lack of presence of major international retailers. The following list is by no means comprehensive but represents some of the more prominent plans for foreign expansion of which we are aware:

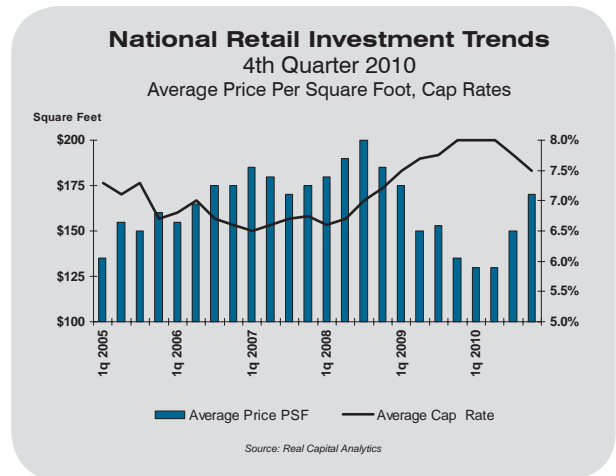
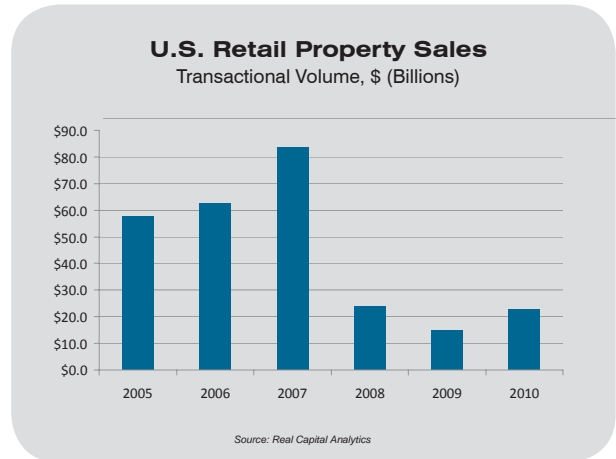
- American Eagle Outfitters has plans for multiple stores in Japan, Dubai, Kuwait, China, Hong Kong, and Israel in 2011.
- Buffalo Wild Wings has announced plans for Canadian expansion and will open its first units early in 2011.
- Burger King is reportedly in negotiations to open its first restaurants in Cambodia.
- California Pizza Kitchen recently opened its first Chinese corporate-owned location and is looking for more. The chain also recently debuted in Mexico City and is looking to open multiple units in Mexico over the next couple of years.
- The Cheesecake Factory recently signed a franchise deal to open as many as 22 new restaurants over the next five years on the Saudi Arabian peninsula.
- Chili's recently opened its first Moscow location and plans future Russian growth. The chain is also planning rollouts in China, Brazil, and India.
- Domino's recently inked a franchise deal in Vietnam and continues with strong Asian growth in multiple markets. All told, the chain wants to open at least 300 units internationally in 2011, many in China.
- Dress Barn and its concepts, Maurices and Justice, are looking for Canadian sites.
- Five Guys Burgers and Fries has announced plans for Canadian expansion and will open its first units early in 2011.
- The Gap recently opened its first Chinese store and is looking for more sites. The chain also recently inked a franchise deal for Chile and plans to push ahead with South American growth in 2011. Expansion is also in the cards for Italy, with two stores expected to be open by midyear 2011.
- Hooters is looking to open as many as 400 units over the next few years, at least 75% of which will be in foreign markets. The chain's concept has proven to be extremely popular in Shanghai, Beijing, and Istanbul.
- J. Crew is opening its first Canadian store in 2011 and plans more locations.
- Jamba Juice plans on 125 Canadian units over next decade.
- McDonald's is looking to Asia for growth and hopes to have 2,000 units in China by the end of 2013.
- The Melting Pot has announced plans for Canadian expansion and will open its first units early in 2011.
- Menchie's Frozen Yogurt has announced plans for Canadian expansion and will be opening its first units early in 2011.
- Office Depot recently purchased Swedish office supply retailer Svanstroms Gruppen and will use that platform to boost its presence in Scandinavia.
- Pollo Tropical has announced plans for Canadian expansion and will open its first units early in 2011.
- Popeye's recently opened its 50th Canadian location and plans more units in 2011.
- Quiznos recently inked a franchise deal to open at least 15 new units in Kuwait. The chain is also looking at adding as many as 40 new stores in India. Quiznos's long-term goal is to expand to as many as 40 countries over the next few years.
- Starbucks is planning to open 400 new international units in 2011. The company wants 1,500 units in China by 2015. Starbucks also recently inked its first franchise deal in India and will open its first units there by summer 2011.
- Stride Rite recently inked a Chinese franchise deal and plans strong Asian growth in 2011.
- Subway is looking to open as many as 50 units in Saudi Arabia by the end of 2011.
- Target recently purchased Canadian retailer Zellers for over \$1.8 billion. The move paves the way for Target to rebrand Zellers's 220 stores in the coming year.
- Tossed recently signed a franchise deal for the Vancouver market and is looking to expand farther in Canada.
- Victoria's Secret is focusing most of its growth efforts in 2011 on Canada, with numerous stores in the works across most major markets.
- Wal-Mart is looking to aggressively expand its small-format (roughly 40,000 square feet) grocery concept in China. Recent purchases of stakes in retailers in India and South Africa will allow for more growth overseas as well. Wal-Mart also continues aggressive expansion in Canada (40 superstores currently planned), Mexico, and Brazil.
- Wendy's/Arby's, though Arby's is currently on the selling block, is planning on expanding in Argentina. The chain recently signed a franchise deal to develop 50 units over the next 10 years.
- Wingstop has plans to enter Mexico with 20 restaurants in 2011.
- Yum! Brands is looking to open as many as 1,400 new international units in 2011, including 475 stores in China, across all of the company's brands (A&W, KFC, Long John Silver's, Pizza Hut, Taco Bell, etc.). KFC is particularly popular in China and India. In India alone, KFC is hoping to have 500 outlets by 2015.

Retail Investment Outlook— Trophies, Trash, & 'Tweeners

Retail investment activity skyrocketed over the final half of 2010. The most recent data from Real Capital Analytics (RCA) indicates that retail property sales in 2010 surpassed the \$22.6 billion mark, with the majority of the activity taking place during the third and fourth quarters. By contrast, the market recorded only \$15 billion in retail transactions in 2009. Still, this is far below the \$83.4 billion in total volume that the market recorded at its peak in 2007.

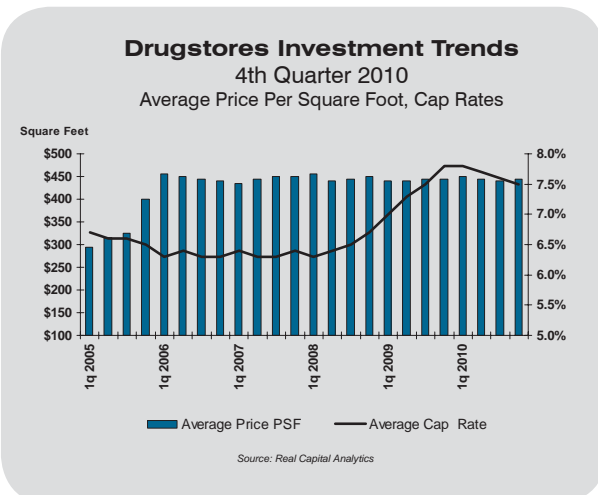
There are a couple of trends that emerged in 2010 that are misleading on the surface. First, based upon these sales, the average price per square foot of retail properties that were transacted increased to \$168 per square foot, a jump of about 30% from the average price per square foot that we saw in 2009's deals. Cap rates, meanwhile, dropped from a peak of 8.2% in the first quarter of 2010 (this number stood at 8.1% one year before) to 7.7% by the fourth quarter of 2010. While these are certainly encouraging numbers for a sector that saw pricing drop through the floor in 2008 and 2009, the reality is that these numbers were somewhat skewed.

Of the \$22.6 billion of retail transactions that took place in 2010, roughly \$2.2 billion were distress sales. This number is up from 2009; according to RCA, roughly \$3.1 billion in total retail distress sales have taken place since the beginning of this down cycle. But this still accounts for only about 10% of the total deal volume we experienced last year. So what sold in 2010? It was primarily trophy assets. This helped to skew averages upward—something we are not likely to see in 2011 as investment activity spreads beyond the trophies versus trash dichotomy that ruled the market in 2010.



Triple Net Leased Properties Remain Strong

If 2010 was the year in which the investment market divided itself into trophies versus trash, triple net leased investment properties clearly landed on the trophies side of the ledger. Investors were willing to pay top dollar for properties with long-term leases in place to stable national credit tenants. The stability of tenancy is key here—remember, investors are really buying income streams.



This is why, for example, in the drugstore arena, pricing for Walgreens and CVS properties with long-term leases in place has typically been from 10% to 30% higher than the prices achieved for similar buildings with Rite Aid in place. Investors remain concerned over Rite Aid's overall fiscal health, and this has impacted pricing.

That being said, in terms of triple net lease drugstore sales, we are tracking a current national average sale price of roughly \$450 per square foot and an average cap rate of 7.5%. Among the markets where drugstore sale activity has been greatest are Chicago; Boston; Atlanta; New York City; Miami; Baltimore; San Diego; Washington, D.C.; and Minneapolis. Some of the most active buyers in the drugstore arena over the past year have been Cole Real Estate Investments, Walgreens, American

Realty Capital, Gramercy Capital Corporation, The Landes Group, and Harbor Group International.

In terms of other single-tenant retail properties, fast-food and automotive service retail remain among the most sought-after investments. Highest pricing, of course, is being achieved for properties that house the more stable concepts. With the impact of the Great Recession, it comes as no surprise that some of the most successful fast-food chains over the past two years have been those that rolled out bargain or dollar menus—with McDonald’s leading the charge. As one investor told us, “Anything with a good dollar menu translates into a seven cap rate.” Of course, it is not that simple, but cap rates in the 7% range are where we are seeing stronger fast-food concepts trading. But for concepts in which there are concerns over stability (Arby’s, for example, which Wendy’s/Arby’s currently has on the selling block), we have seen cap rates in the eights and above. In terms of automotive retail, Pep Boys, CSK, Goodyear, Jiffy Lube, and America’s Tire locations all remain among the most sought-after properties. Depending upon the individual circumstances of the property, these have typically commanded cap rates in the 7% to 8% range.

2011: From Bifurcated Market to Trifurcated Market

Just as the best way to understand the story behind today’s vacancy numbers is to break the shopping center market down into first-, second-, and third-tier properties, the best way to understand current investment trends is to segment the market. As we entered 2010, the investment market was at a stalemate. Pricing for retail properties nationally had dropped a full 40% from peak 2006/2007 levels. Commercial delinquencies were surging, and investors readied themselves for a tsunami of distressed assets to hit the marketplace and further crash real estate values. REITs raised over \$40 billion in preparation for the fire sale to come. But the tsunami never came.

While note sales, portfolio sales, and loan workouts played some role in mitigating the number of distressed assets that came back to the marketplace, the primary reason that the market was not flooded with distressed assets was that banks simply opted not to foreclose. “Pretend and extend” or “pray and delay” became new terms in the commercial real estate lexicon as commercial lenders—predominately smaller local and regional banks—delayed taking action on properties falling into default.

This was still not enough to save many banks from failure over the past year, and 2010 was the worst year for bank failures since the savings and loan crisis in 1992. Some 157 banks failed in 2010, following 140 bank failures in 2009. Yet, though we have seen the ranks of distressed assets increase

substantially over the past 24 months, there was no tsunami, and prices began to stabilize in 2010.

We entered the year against this backdrop, with the investment market in gridlock as investors held out for discounted pricing and the bid-ask spread between buyers and sellers seemed an enormous chasm. But as pricing and market fundamentals began to stabilize over the course of 2010, a clear bifurcation in the marketplace began to appear. Investors and REITs that had raised war chests of cash that needed to be placed returned to the marketplace and began pursuing the healthiest commercial real estate assets. Two sets of pricing for nearly every commercial real estate asset class emerged as investors increasingly divided the market into trophies versus trash.

Throughout 2010, investors were focused largely on just a few commercial real estate asset types. Trophy shopping centers, retail triple net leased properties, and stabilized Class A office assets in just a handful of metro areas (San Francisco, New York, Boston, Washington, D.C., Chicago) were the focus of most activity. This drove up pricing for these

Major 2010 Portfolio Sales

Portfolio	Buyer	Total SF	Price (\$M)
Prime Outlets	Simon	6,005,000	\$1,810.5
Centro/Inland American	Inland American	4,500,000	\$471
Inland/DDR/TIAA-CREF	Inland American	3,553,000	\$424
West Coast Strip Centers	Big Shopping Centers LTD	2,246,000	\$394.3
Inland Western Retail	RioCan REIT	1,192,000	\$165.5
PREIT Retail	Cedar Shopping Centers	1,018,000	\$129.6
RioCan Cedar Joint Venture	RioCan REIT	904,000	\$108.4
Edens & Avant	Cedar Shopping Centers	663,000	\$91

Major 2010 Retail Sales

Shopping Center	Buyer	Total SF	Price (\$M) / PSF
Festival at Riva Annapolis, MD	American Realty Advisors	304,000	\$102.5 / \$337
Park Place II Irvine, CA	LBA Realty	170,000	\$98.3 / \$578
London Square Miami, FL	RREEF	300,000	\$95.3 / \$319
Creekside Center Roseville, CA	AEW Cap	372,000	\$94.2 / \$253
Stockton Park West Place Stockton, CA	Excel Trust	598,000	\$92.5 / \$155
Gateway Overlook Elkridge, MD	Washington RE Inv Trust	214,000	\$88.4 / \$412
San Jose Market Center San Jose, CA	LaSalle Inv	356,000	\$85 / \$239
Whittwood Town Center Whittier, CA	Cole Real Estate	686,000	\$83.5 / \$122

assets, and we saw cap rates for some properties returning to 5% and 6%—levels we saw at the peak of the last cycle, when the underlying market fundamentals seemed much more secure. There were a number of reasons for this. In many cases, urban office plays were more about securing buildings at far below replacement costs for long-term holds, as opposed to immediate returns. The same goes for trophy shopping centers. Remember, investors may be purchasing buildings, but they are really buying cash flows—so many were willing to pay top dollar for the most secure trophy properties.

Another factor driving up pricing is the issue of too much money chasing too few properties. With investor focus so narrow in 2010, sellers of trophy properties could command top dollar. REITs have raised over \$40 billion from Wall Street over the last couple of years, and this money needs to be placed. Meanwhile, all indications are that the CMBS market will see a resurrection in 2011 after being in a deep freeze for most of the past three years. This will further increase the amount of capital chasing commercial real estate assets.

Heading into 2011, we are already seeing investors who are beginning to look beyond the narrow scope of focus that dominated 2010. Because pricing has shot up considerably for trophy assets in first-tier marketplaces, many investors are now beginning to look at other asset classes and towards properties in second-tier and tertiary markets.

That being said, if 2010 was the year in which we saw a bifurcated investment market with radically different sets of pricing in a trophies versus trash marketplace, 2011 will see the addition of another set of buildings: the 'tweeners.

While we do expect to see continued heavy interest in chasing trophy assets and retail net leased opportunities, higher pricing and cap rate compression will lead more investors to look into 'tweeners. What are 'tweeners? We would define these as assets that include retail properties in a number of circumstances: first- and second-tier shopping centers in primary markets with minor occupancy issues, as well as stronger shopping centers in secondary or tertiary markets that—so far—have seen little of the latest wave of activity. We would also include in this category second-tier shopping centers with excess land and the opportunity for further development, as well as aging centers that are not completely functionally obsolete and in which minor to moderate renovations or redevelopment could significantly boost their standing.

While very few of these 'tweener properties sold in 2010, activity should increase significantly in the coming year. A much greater pool of investors and gradually improving retail conditions should help to boost pricing for many of these properties, but individual property fundamentals will still be the greatest determinant of pricing. For the most part, we expect values to post modest increases, but this will not be across the board.

If 2010 was the year in which we saw a bifurcated investment market with radically different sets of pricing in a “trophies vs. trash” marketplace, 2011 will see the addition of another set of buildings... the “tweeners.”

We will also see increased activity in the distressmarket in 2011. All told, it is estimated that over \$52 billion of retail properties have fallen into default, foreclosure, or bankruptcy since the beginning of the recession. So far, lenders have pursued extensions (more on “pretend and extend” shortly), modifications, and loan workouts/restructurings. RCA estimates that roughly half of this \$52 billion has already been resolved—the largest example of which would be General Growth Properties’s bankruptcy and restructuring. But even with note sales and modifications substantially chipping away at the issue of distressed properties, 2010’s transactional volume of only \$2.2 billion was still much lower than what most analysts had expected.

With fundamentals showing signs of life, and with a much greater pool of investors seeking assets, expect banks to increase the rate of foreclosures on properties that have been in “pretend and extend” limbo for much of the past two years. The irony is that, while the headlines will read that commercial foreclosures are up, this is actually because market conditions are improving. Lenders will expect to sell their REOs at higher pricing in 2011 than what could have been achieved last year simply because the pool of buyers will be greater. Of course, this remains to be seen and will be largely dependent upon just how many REOs hit the market at any given time. But the underlying fundamentals of the specific properties being sold will still be the greatest determinant here. In many markets, and for some property types, pricing is likely to drop. However, in the nation’s strongest markets, improving fundamentals, an increased investor pool, and less aversion to risk could translate into higher pricing for some distressed properties.

Over the next couple of years, as more distressed assets trade hands, one trend to closely watch will be the impact on asking rents. For those properties with occupancy issues, new owners will be in a much better position to slash rents to backfill vacancies. In the meantime, look for retail investment activity of all types to substantially pick up in 2011.



Looking Ahead

The good news is that retailer, investor, landlord, and consumer sentiment all reflects the position that we are past the worst of the Great Recession. Barring any unforeseen macroeconomic disasters, we believe that current forecasts for consumer spending to increase between 3% and 5% in 2011 are right on target. Meanwhile, retailer expansion plans have increased, and deal activity has been on the upswing for the past 15 months. The real question is whether continued consolidation within the industry will eradicate these occupancy gains in the coming year.

As this report went to press, Blockbuster's Chapter 11 bankruptcy seemed near resolution with the court's approval of a plan to auction the chain off to repay creditors. Bidding will start at just \$290 million and many analysts wonder if the beleaguered chain can achieve a price much higher than that. The reality is that Blockbuster's greatest value now is its name recognition and the value this will bring to a reinvented company that depends more on clicks than bricks. Blockbuster has been laying the groundwork for a greater online presence with deals to provide streaming video to TiVo. It also has beefed up its video kiosk business. This is the company's future and the closure of more retail locations is a certainty. Meanwhile, Borders had just announced its own Chapter 11 filing as this report went to press. The chain will be closing 275 stores by late April. This number could potentially go up, but we do not expect a full liquidation here.

Grocery store consolidation remains another issue. The irony here is that grocery store growth plans strongly play into this trend. While most of the growth players are going with footprints of 20,000 to 40,000 square feet, the most vulnerable sector of the market consists of smaller and regional grocers who have primarily traditional footprints in the 50,000 to 70,000 square foot range. Will the market support all of these players? It's unlikely—the pie is simply not big enough.

What will this mean for retail real estate? It will vary market to market, but on the whole we expect the gains from the upstarts to equal the losses that will take place as weaker chains contract or fail. The real difference will be the impact on pricing for junior-box space in that 20,000 to 40,000 square foot range. This is the sector of the big-box market that has seen the most improvement, and this footprint falls into the sweet spot for a wide array of retailers, grocery or not. The quality spaces in this size range are already moving quickly. The real challenge will be what the market does with even more larger-format, vacant big-box space on the market.

Looking forward, we expect new construction to set record lows this year, though we will begin to see the development pipeline conservatively ramp up again in the strongest markets—with a primary focus on redevelopment plays. Suburban shopping center development in most markets is still a couple of years away and, with few exceptions, will simply not happen until new home construction returns.

We see overall vacancy continuing to creep incrementally downward. Beneath the numbers, however, first-tier centers will continue to be the best performers. Second-tier centers finally will begin to “feel the love” in 2011, at least in all but the nation's weakest trade areas. Third-tier centers will simply continue to struggle because, despite the fact that we are seeing retailer requirements up by about 40% from where they were the previous year, the mom-and-pop sector is still on the sidelines. Mom-and-pops are slowly trickling back into the marketplace, and the first place they will return in any substantial numbers will be in those stable housing markets that avoided the boom-bust that helped bring on the recession to begin with. For the hardest-hit housing markets, like those in Florida, Las Vegas, Phoenix, and California's Central Valley, it still could be four years or more before we see mom-and-pops return in major numbers. Mom-and-pops are the lifeblood of unanchored strip center tenancy, and until they are back, the outlook for third-tier centers will be one of challenges.

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ABOUT GARRICK BROWN



Garrick Brown is the Research Director for Terranomics, part of the Chainlinks network. Mr. Brown is the editor of the Terranomics Retail Newsline, which is distributed weekly to over 15,000 retail decision makers nationally. He speaks frequently at industry events and has been a keynote speaker at symposiums, conferences and market forecasting events for groups like the Appraisal Institute, Urban Land Institute, CREW (Career Real Estate Women), ICSC (the International Council of Shopping Centers), NAIOP (National Association of Office and Industrial Properties) and PRSM (the Professional Retail Store Management Association). He is a member of the ICSC, ULI and NAIOP. Garrick works closely with the media and has been quoted national publications such as the Wall Street Journal, Bloomberg, the Financial Times, USA Today as well as numerous local publications, business journals and trade publications. Prior to joining Terranomics, Mr. Brown served as the Director of National Retail Research with Colliers International.