Positive Retail Consumption and Favorable Fundamentals Reiterate Investment Opportunities

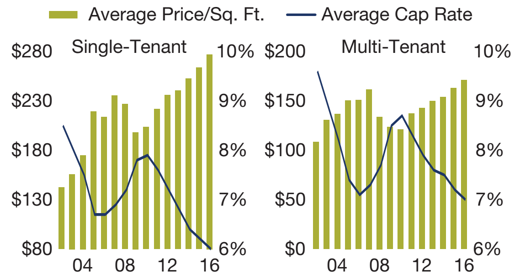
Investor optimism reinforced by continued retail property momentum. Healthy job creation and wage growth will carry through 2017, boosting retail sales and encouraging retail tenant expansion. Construction remains limited, pushing growing retailers into existing centers and further tightening vacancy over the coming year. While a variety of high-profile store closures have left large blocks of space vacant this year, opportunistic investors in search of upside are taking initiative to re-tenant the space with a variety of smaller format retailers. While growth in e-commerce is shifting how consumers shop for goods, a variety of traditional brick-and-mortar stores are expanding their online platforms. Conversely, online retailers such as Amazon are recognizing the importance of a physical storefront as they open pop-up stores and full bookstores, further developing their omnichannel retail efforts.

Retail assets in secondary/tertiary markets may capture additional capital this year. Overall pricing and cap rates have surpassed their pre-recession peaks, with much of this recovery concentrated in primary markets. Yet, many secondary and tertiary metros still offer unique opportunities as prices offer a discount from their previous peak. Tertiary markets in particular are gaining traction with investors, evidenced by deal volume nearly doubling in these metros since 2007. Cap rates in secondary and tertiary metros are often 50 to 100 basis points higher than primary markets and garner strong interest from private buyers seeking higher returns. Healthy job creation and rising incomes in these markets will attract expanding retailers, improving vacancy and boosting NOI growth.

2017 Investment Outlook

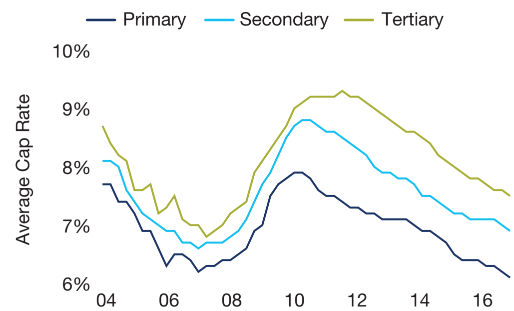
- **Big-box store closings offer investors new opportunities.** Several big-box retailers that traditionally anchor shopping centers and malls continue to close, presenting some landlords with the opportunity to redevelop these empty spaces and boost yield. Redevelopments into smaller format stores and restaurants are increasing traffic at these centers and attracting a wide range of merchants. As tenant mixes are revamped and customer traffic rises, owners are generating more revenue through higher rents.
- **Single-tenant investment sensitive to widening yield spread.** Investors seeking stable returns remain focused on single-tenant properties and smaller strip-center assets leased to nationally recognized and credit tenants. Strong investor demand for single-tenant properties has squeezed overall initial returns from 7.9 percent in 2010 to 6.0 percent last year. With interest rates set to rise further this year, the yield spread is narrowing, causing higher-leverage investors to reconsider their options. For low-leverage investors trading out of more-management-intensive properties, these deals still present attractive investment opportunities.
- **New retail paradigm will shape acquisition strategies.** The rising popularity of online shopping and expanding e-commerce are pushing retail investors to revise their tenant mix. As a result, landlords are favoring retailers that are difficult to disintermediate through online options. Food-service sales are up more than 50 percent since 2009, while building-materials and home-improvement store sales have risen nearly 45 percent during the same span. Health and fitness locations have also expanded into larger retail spaces.

Retail Property Sales Trends

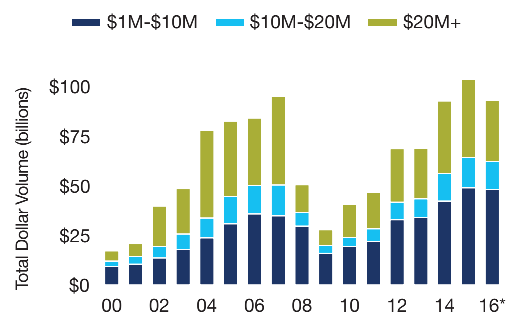


Sales figures represent transactions of $1 million+.

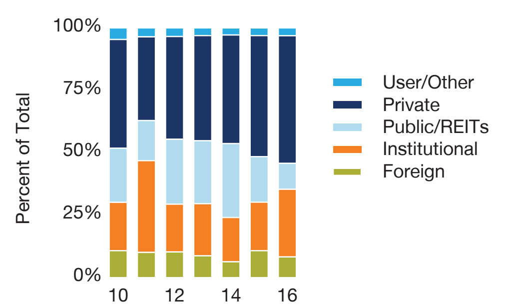
Retail Cap Rate Trends by Market Type



Retail Sales Volume by Price



Retail Buyer Composition



* Estimate