RetailResearch

SINGLE-TENANT OUTLOOK

Marcus & Millichap

First Half 2009

Despite Recession, Discounters Performing Well

The recession is proving to be a significant challenge for most retailers, with many businesses shuttering locations in an attempt to contain costs. Casual dining restaurants are especially hard-hit, as more individuals are opting for home-prepared meals in order to trim expenses. Red Robin will close 10 percent of its company-owned facilities, and Darden Restaurants, which owns LongHorn Steakhouse and Red Lobster, has announced plans to slow the rate of new store openings by nearly 20 percent this year. As consumers grow increasingly cost-conscious, opportunities are emerging for discount retailers. Dollar General plans to double its store openings during the next fiscal year in response to annual sales growth of more than 9 percent, while Family Dollar will target sites for renovation and operational upgrades.

The single-tenant net-lease retail sector is expected to register far fewer 1031-exchange transactions in 2009. This trend, which began to emerge in the second half of last year, stems primarily from these investors' difficulty in trading out of more management-intensive apartment properties due to higher vacancy rates and stricter lending criteria. In addition to declining sales velocity, some exchange investors are modifying their strategies; these buyers are expected to attempt to shift their portfolios out of several smaller properties into one or two larger assets, reducing management responsibilities. This will likely lead to an increase in the number of smaller assets available for sale and heightened demand for larger, high-quality single-tenant properties. Cash buyers, meanwhile, are expected to try to take advantage of current conditions by acquiring distressed assets below peak market values.

Single-Tenant Retail Market Overview

7.5% Cap Rate
Up 30
Basis Points
4Q07-4Q08

Quick-Service Restaurants: Starbucks is attempting to manage costs by closing 600 stores, down from previous plans for a 1,000-unit expansion. McDonald's and Wendy's continue to increase customer traffic through dollar menu options.

8.2% Cap Rate
Up 80
Basis Points
4Q07-4Q08

Convenience Stores/Gas Stations: As oil prices advanced and receded, sales at convenience stores/gas stations fluctuated considerably. Fuel costs appear to have stabilized well below their peak, which should result in increased spending on higher-margin in-store items.

7.5% Cap Rate
Up 20
Basis Points
4Q07-4Q08

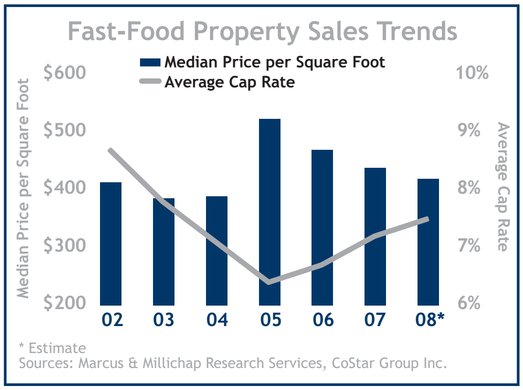
Casual Dining: The impact of declining consumer confidence and cooling spending is evident at casual dining restaurants. As sales slow, many restaurant chains are shuttering locations or limiting expansion plans.

7.3% Cap Rate
Up 60
Basis Points
4Q07-4Q08

Drugstores: CVS and Walgreens still dominate the drugstore market, although front-end sales are beginning to weaken as consumers cut spending. In January, Walgreens announced same-store sales growth of 0.4 percent, despite a front-end sales decline of 0.9 percent.

7.3% Cap Rate
Up 20
Basis Points
4Q07-4Q08

Grocery Stores: Smaller, locally based grocery chains are expected to continue to struggle this year as price wars are won by larger brands' economies of scale. Transaction velocity for all grocery stores fell 17 percent in 2008.

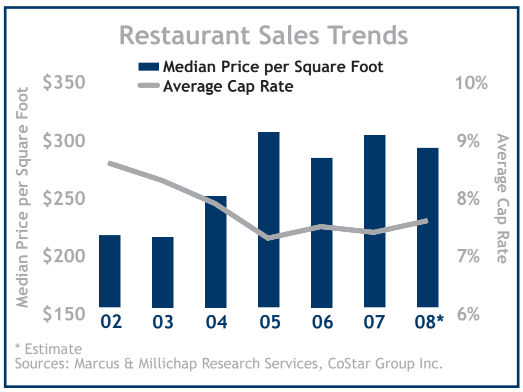


QUICK-SERVICE RESTAURANTS

Fast-Food Not Immune to Economic Downturn

Late last year, Starbucks announced plans to shutter 600 stores and open fewer than 200 U.S. locations in fiscal 2009, down from a previously planned expansion of 1,000 new sites. These trends highlight the impact of the weakening economy on even some of the traditionally top-performing quick-service restaurants. As Starbucks is looking to contain expenses, McDonald's is trying to increase margins. The company is replacing its double cheeseburger on the Dollar Menu with the McDouble, which costs $1.19.

While quick-service restaurants will remain popular with investors, most buyers are exercising increased caution when selecting assets. As with many other property types, investors are favoring urban locations in primary markets where population density supports demand. As a result, quick-service restaurants in secondary and tertiary markets or those in outlying submarkets are recording reduced investor interest, even as average cap rates have pushed up into the mid-7 percent range in recent quarters.

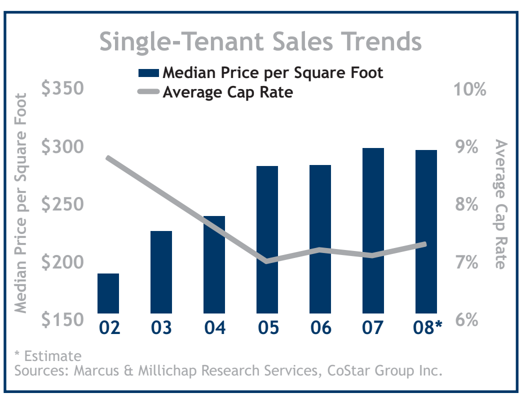


CASUAL DINING RESTAURANTS

More Home-Cooked Meals a Concern

One of the immediate impacts of the recession has been the decline in customer traffic in restaurants. As payrolls have contracted and confidence has fallen, people are choosing to eat more meals at home, contributing to decreased sales at casual dining properties. Reduced leisure and business travel also has cut into casual dining traffic. As a result, some chains are choosing to downsize in an effort to contain costs. Ruby Tuesday announced plans to close nearly 70 locations, or 10 percent of its company-owned restaurants, in the coming years. In addition, the company will sell at least 35 parcels that were intended for the building of new stores.

Investment activity in casual dining is expected to continue to cool as investors and lenders become more thorough in their review of the financials of tenants, franchisees and parent companies. Deals will still get done, as the asset class remains a buyer favorite due to its typically low price points and cap rates that are in the mid-7 percent range and creeping higher. Given the current economic weakness, aggressive buyers seeking distressed properties may find a number of opportunities in casual dining restaurants.



DISCOUNT STORES

Some Discounters Still Expanding

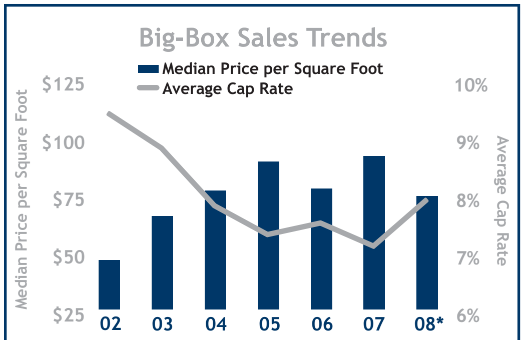
Economic uncertainty has caused many consumers to look for additional ways to cut costs, resulting in a steady performance at discount retailers. At Wal-Mart, comparable same-store sales growth of 3 percent in the fourth quarter exceeded analysts' expectations. A profitable 2008 has encouraged Dollar General to double the number of new store openings this fiscal year to 450 locations. Family Dollar, meanwhile, announced in late January that quarterly earnings were up a better-than-expected 14.1 percent.

Transaction velocity for discount stores picked up 17 percent last year, while the median price rose 22 percent to $104 per square foot. Some of the price growth is attributable to new properties trading during that time, rather than across-the-board appreciation. Cap rates have averaged in the high-7 percent to mid-8 percent range during the past year.

Big Box

Woes for Electronics Retailers

Big-box electronics chains were some of the primary beneficiaries of the tremendous wealth that was created during the housing boom, as consumers spent equity to upgrade their homes. Sales have dropped off dramatically during the downturn, however, as evidenced by Circuit City announcing the closure of all of its nearly 700 U.S. stores, a move that will result in approximately 15 million square feet of vacant space. Competitor Best Buy is still operating, but plummeting sales have caused the electronics giant to sharply reduce its profit forecast. Another contributor to Circuit City and Best Buy's ongoing struggles is discount retailer Wal-Mart, which continues to increase its market share through competitive pricing.



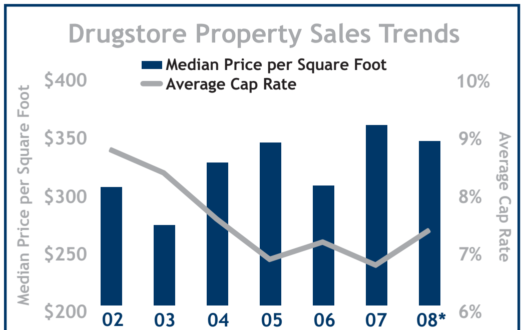
* Estimate
Sources: Marcus & Millichap Research Services, CoStar Group Inc.

Despite average cap rates rising into the high-7 percent range in 2008, sales velocity in the big-box sector is forecast to decelerate this year. Given the recent wave of big-box store closures, securing tenants for large blocks of space is going to be a significant challenge in a contracting economy. This difficulty is likely to drive away many buyers until signs of a turnaround emerge.

Drugstores

Buyers Beginning to Balk at Drugstore Prices; Cap Rates Rising

The drugstore market continues to be dominated by its two largest participants. During the fourth quarter, CVS Caremark acquired Longs Drug Stores, as well as the company's pharmacy benefits management service, RxAmerica. The transaction makes CVS the largest drugstore chain in the United States, with approximately 6,800 stores. Walgreens, the nation's second largest chain, at nearly 6,500 locations, has announced several initiatives intended to cut costs and strengthen its core business over the next several years. The presence of these two major players, along with Wal-Mart's generic drug program, is making it difficult for Rite Aid to compete.



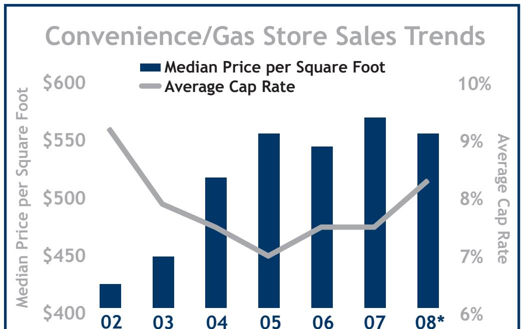
* Estimate
Sources: Marcus & Millichap Research Services, CoStar Group Inc.

A reduced number of 1031-exchange buyers in the marketplace this year will significantly affect drugstores. Traditionally, investors have favored this property type due to the low risks typically associated with these assets; however, the nation's for-sale drugstore inventory has increased, as many buyers have not been swayed by average cap rates that have climbed past 7 percent. Although the majority of transactions contain corporate guarantees, sales velocity has dropped off and prices have dipped, trends that could continue through the next few quarters as constrained capital markets and fewer sales of other property types reduce the number of qualified buyers.

Convenience Stores/Gas Stations

Lower Gas Prices Paying Off for Operators

The past year has been a turbulent one for owners and operators of convenience stores/gas stations. Fuel costs were incredibly volatile in the second half of 2008 but appear to have stabilized. Despite a steep decline in retail sales at gas stations, lower fuel prices are resulting in higher profit margins for operators; as prices have receded, customers have become more likely to spend on higher-margin in-store items.



* Estimate
Sources: Marcus & Millichap Research Services, CoStar Group Inc.

In 2008, sales velocity for convenience stores/gas stations surpassed the levels recorded in the prior year, as investors were attracted to the sector's cap rates, which increased roughly 80 basis points in that time to the low-8 percent range. As profitability among operators continues to accelerate, these properties will likely remain a preferred choice among investors.

Grocery Stores

Grocers Market Private Labels to Maintain Profits

A shift in consumer spending away from casual dining has resulted in an uptick in grocery sales. Both Wal-Mart and Kroger, two of the nation's largest grocery retailers, announced recent gains in customer traffic and subsequent rises in profitability. Currently, the primary hurdle for many grocers is the inflationary pressure on brand prices. Despite the recent decline in commodities prices, major brands such as Nabisco, General Mills and Kraft have yet to pass along the savings to retailers. In response to manufacturers' concerns over whether or not commodity prices will rebound within the next six months, major grocers are promoting private-label brands in an effort to capture lost profits, a move that supported private-label growth of more than 10 percent last year. Another strategy some grocers are employing is the use of a smaller store footprint. Wal-Mart continues to move forward with its Neighborhood Market brand, while Safeway is testing its 15,000-square foot Market concept, and Jewel-Osco has introduced Urban Fresh locations in Chicago. The smaller formats offer fewer items, however, the products sold in the store often feature higher profit margins.

While grocers cite increasing costs as one reason for smaller store formats, some of the new concepts are in response to the ongoing expansion of British retailer Tesco. The company's 10,000-square foot Fresh & Easy stores now number approximately 100 locations throughout the West. Over the past year, Fresh & Easy stores in Arizona and Southern California have traded at approximately $250 per square foot and with average cap rates in the high-5 percent to low-6 percent range. Transaction velocity nationwide for grocery stores has fallen 17 percent year over year, while the median price has declined 10 percent to $183 per square foot.

Recent Single-Tenant Sales Highlights

Property Name	City, State	Sales Price	Cap Rate	Price/ Sq. Ft.
Walgreens	Aubrey, TX	$5,239,400	6.6%	$354
Piggly Wiggly	Appleton, WI	$3,937,000	7.7%	$125
OfficeMax	Anniston, AL	$3,075,000	7.8%	$131
Arby's	Terrell, TX	$2,216,776	7.2%	$739
Famous Sam's Sports Grill	Gilbert, AZ	$1,800,000	7.3%	$265
Checker Auto Parts	Phoenix, AZ	$1,755,500	6.1%	$251
Starbucks	Indianapolis, IN	$1,122,666	7.5%	$357
Wendy's	Stone Mountain, GA	$1,101,375	10.2%	$396
Carrows	Antioch, CA	$1,100,000	6.8%	$252
Sonic Drive-In	Collinsville, IL	$867,989	9.2%	$617
Popeyes Chicken and Biscuits	Wilkinsburg, PA	$770,000	8.8%	$367
Family Dollar	Delta, CO	$765,000	8.5%	$95

Marcus & Millichap
NATIONAL RETAIL GROUP

Visit www.NationalRetailGroup.com or call:
Bernard J. Haddigan
Managing Director
Tel: (678) 808-2700
bhaddigan@marcusmillichap.com

Marcus & Millichap
RESEARCH SERVICES

Prepared and edited by
Greg Clemmer
Market Analyst
Research Services

For additional research on retail market trends, contact:
John Chang
National Research Manager
Tel: (602) 952-9669
john.chang@marcusmillichap.com

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