RETAIL SENTIMENT REPORT

MAY 2017

Real Capital Markets

In May 2017, Real Capital Markets surveyed its database of retail investors to gauge their sentiment on investing in today's market, the greatest threats to the industry, the factors most influencing their acquisition decisions and where they see the greatest opportunities. Respondents included principals and brokers from across the country.

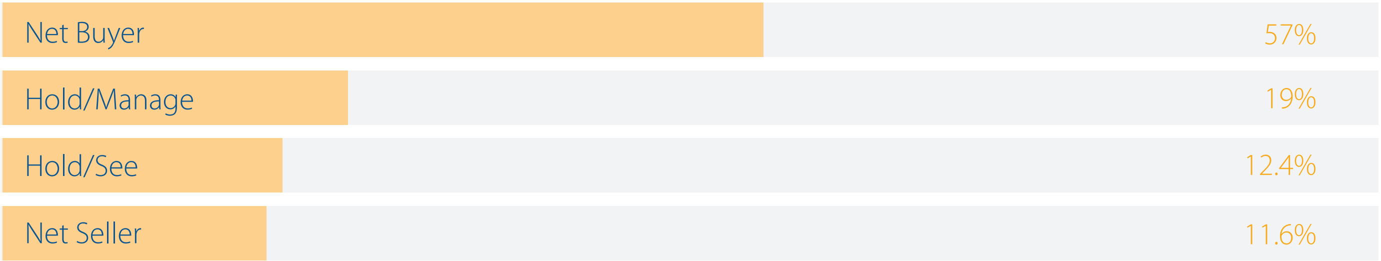
Highlights of the RCM retail study include:

- Approximately 75 percent of respondents said the current and future challenges in the retail sector—either by themselves or in combination with general **economic** issues—are impacting their acquisition plans.
- **Interest rates** are not a great motivating force for acquiring real estate now to lock in rates; fewer than 40 percent of all investors surveyed said increasing interest rates today would influence their activity.
- More than one third of investors (35.8 percent) identified shifting consumer buying habits as the greatest threat to retail investing, but the impact of **e-commerce** and big box vacancy followed closely behind, at 29 and 25 percent, respectively.
- Anchored shopping centers, including **grocery-anchored**, are viewed almost across the board as the most attractive retail investment opportunity, a category cited by more than 40 percent of investors.

While there remain significant challenges in the retail property sector, investors are generally optimistic and are reshaping their investment decisions to adjust to the new age of retail. As the retail sector continues to evolve, with large tenant shake-ups and e-commerce pressures, investors are focusing on anchored retail centers, particularly those with grocery tenants, as one positive path for future growth, according to Real Capital Markets' May 2017 Retail Sentiment Report.

Investors are Net Buyers

According to the study, respondents defined themselves as the following types of investors:



In identifying specific groups and their likely activity patterns, Chris Angelone, a Managing Director with JLL, says most groups are net buyers. “If they already own good retail property, they don’t want to sell, especially if they can’t replace the opportunity they are selling,” he said.

Across the board, investors and their advisors point to great opportunity in the retail sector, noting that by and large, institutions are underweighted in their investment in retail properties. The consensus is that with capital costs being lower, and gains from other asset classes having pushed up overall portfolio values, the right retail assets are a welcome addition to a real estate portfolio.

Pension firms and life companies, for example, are often net buyers today because they are under allocated when it comes to owning and managing retail properties, Angelone added. The great success many investors have had with multifamily assets, among others, skews the value of their real estate investment portfolio making them prime targets for acquisitions. Also, public REITs generally are “net sellers of assets that don’t fit their portfolios,” he said.

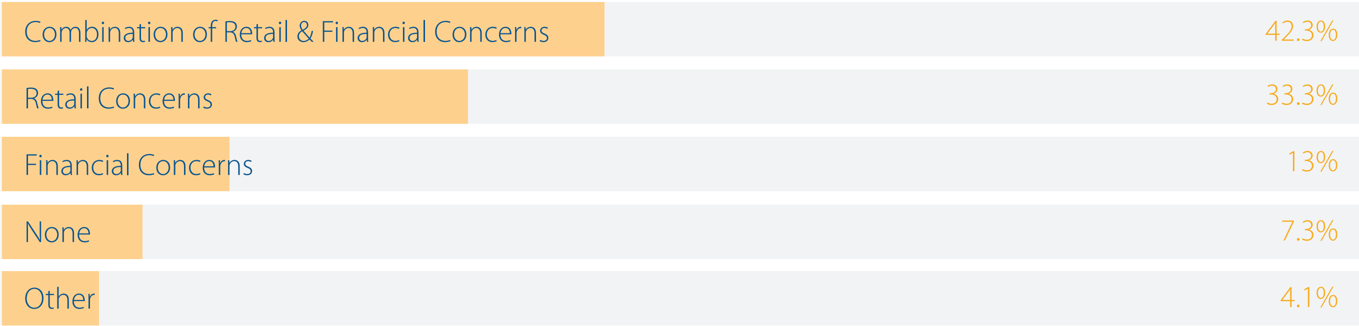
In conclusion, most private investors will call themselves net buyers because they are always in search of the right acquisition opportunities.

Overall, survey respondents noted that all categories of buyers, from large institutional investors to small private buyers, seem to believe that retail is an important part of a balanced portfolio, and an asset class that is seeing substantial cash flows.

Retail Environment is Greatest Influence

Clearly there are many things that can influence and have a significant impact on an investor's motivation to acquire property. However, none are more resounding than the current state of retail, where the number of retailers facing significant challenges is growing each day. That trickles down to increased vacancies.

One third of investors said that the current state of retail is having, and will continue to have, an impact on their acquisition plans. While only 13 percent pointed exclusively to the financial market conditions—interest rates, availability of capital/cash, etc.—as the greatest impact, more than 42 percent said the one-two punch of retail issues and financial market concerns are the greatest impact on investment position.



On the bright side, almost 10 percent are ignoring the state of retail, the financial markets and politics, saying these issues have little to no bearing on their investment position. And, almost surprisingly, less than one percent said the political climate in the United States is having an impact.

"Participants in our Retail Sentiment Report confirm that a confluence of events, some that are years in the making, are having a significant impact on this segment of commercial real estate."

Tina Lichens
COO, Real Capital Markets

Shifting Consumer Buying Habits are Greatest Threats

The RCM survey asked investors to select among three possibilities to identify the greatest threat to investing in retail real estate today. There was no runaway winner among the three responses:

Shifting Consumer Habits	35.8%
Impact of E-Commerce	29.3%
Big Box Vacancy & Re-Tenanting Issues	24.4%
Other	10.6%

"Retail closures do not mean the end of bricks and mortar business as we know it," said Brad Hutensky, CEO of the retail real estate opportunity fund manager, Hutensky Capital Partners. "Retail real estate is going through a natural realignment that overall is characteristic of a healthy sector."

However, most investors agree that it isn't and likely won't be a painless process.

> "This is what a healthy industry does".
>
> Brad Hutensky
> Hutensky Capital Partners

Hutensky continued, "Quality big box spaces, in quality locations, ultimately will get leased by strong tenants that have determined their online and bricks and mortar strategy."

Some investors suggest that it may be a good thing that there is no clear greatest threat. Investors and consumers alike are realizing that there are a lot of issues facing the retail industry; this means that there is no easy fix and that people need to get creative at mitigating risk.

Some investors generally are not optimistic about the overall state of retail given the level of bankruptcies they believe will continue as well as other disruptive forces such as e-commerce. Others expressed a belief that the general format of a lot of retail, including some large malls and power centers, and the inability of some to create a meaningful customer experience, doesn't work and isn't efficient.

Disruption...Makes its Way to Retail

Not surprisingly, the impact of e-commerce was cited as the greatest threat for investors active in the acquisition of retail properties over $50 million.

"The reality is that there is so much uncertainty in retail," Angelone said. "This is a disruptive period, just like many other industries have faced."

Investors point out that e-commerce is having a significant impact on the way consumer buying habits are changing. The disruption in the industry, according to investors, is exposing flaws in the existing model, in general and specifically for many retailers.

Angelone added that some retailers, and retail centers, have failed to create or maintain a shopping experience that is unique for today's shoppers.

"We're seeing the impact now, and it's forcing retailers to reinvent themselves, blending together their online and bricks and mortar strategy."

Because e-commerce can be seen as both a positive and negative, private, public and institutional investors generally all agree there is no single fix, and it certainly isn't a quick fix.

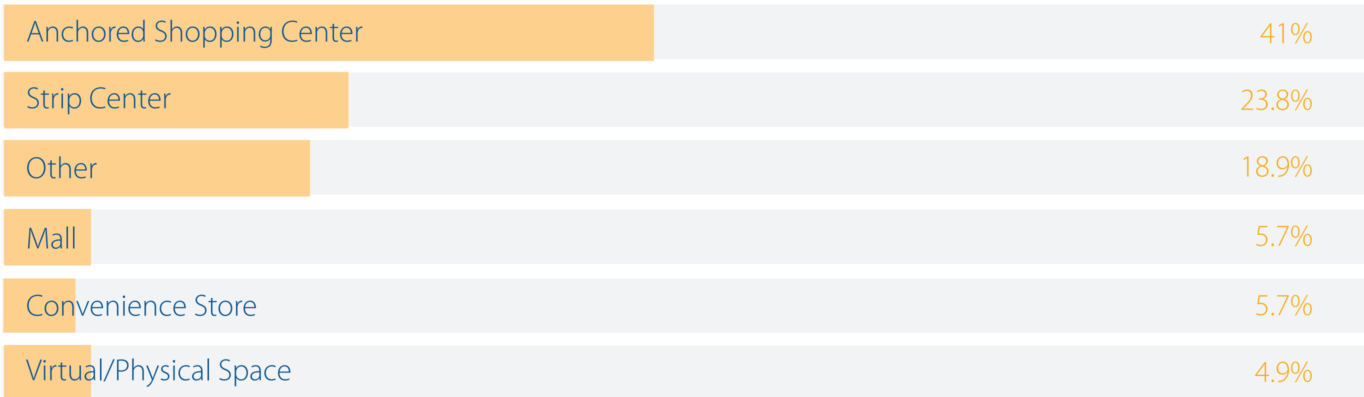
"E-commerce represents another tool in a retailer's arsenal, and the good retailers use e-commerce and in-store strategies to help grow the overall business," Hutensky said.

"With all the disruptive change that is occurring in the industry, retailers are looking at all avenues of re-invention including the modification of store formats and reduction of square footage. The fix is reinvention."

Chris Angelone
JLL

Shopping for Anchored Centers

Anchored shopping centers are viewed almost across the board as the most attractive retail investment opportunity; the other interests included:



The general sentiment is that anchored centers are a property type that can be more easily underwritten than other property types. There is lots of data available to assist in the underwriting and due diligence process; that makes anchored centers the easiest to underwrite and the safest of retail investment formats.

A number of respondents noted that they were especially interested in grocery-anchored investment options.

“Consumers are not getting away from hitting the grocery store once a week.”

Institutional Real Estate Investor

As one institutional investor put it, “The reality is that while many are ordering online, you can’t get everything online. And as hard as people try to order everything they’ll need, for a meal or for the week, we all forget. And when you forget, you need to go to the grocery store, not just for the forgotten item, but also for the things that come to mind as you are there.”

Though these are among the most popular of the retail sector investments, approximately 24 percent see strip centers as the most attractive, while similar numbers of almost six percent view malls and convenience stores as attractive opportunities. Less than 10 percent of investors identified a range of other types of properties they are pursuing.

While assessing the attractiveness of the certain retail property types for acquisitions, there continue to be concerns about various sectors. Those aren’t always tied to the specific property type, but rather the type of tenant(s) leasing space(s) in those properties. As an example, one participant noted great concern for the impact soft goods retailers are having on strip centers as well as malls and what troubled tenants in that area would have on the appeal of those properties.

In explaining institutional interest in grocery anchored centers, one investor stated that e-commerce disruption seen in the grocery segment is a longer process and more defensible than many other retail property types.

Interest Rates Don't Motivate

The RCM survey also indicates there is little or no correlation between investors characterizing themselves as net buyers and higher trending interest rates.

Yet in spite of rate increases dating back to last Fall and the prognosis for even further hikes, investors aren't motivated to accelerate their acquisition plans in order to lock in rates at what continue to be extremely low rates. According to the survey, almost 63 percent of respondents said interest rate activities will not be the motivating factor.

"Someone investing in real estate should be focused on the underlying, unlevered issues such as performance, tenancy and competitive forces," Hutensky said. "Then they apply the leverage, after the decision to buy has been made."

He also said the issue of interest rates is very dependent on investment strategy. Value-add investing, for example, really isn't as susceptible to interest rate or cap rate factors because the NOI will increase as the value is being created. With core properties, it can be a bigger issue because of the net operating income that is much flatter.

Angelone suggested that just the contrary is true for sellers. Not surprisingly, the higher the price tag for the investment, the less likely interest rates are to influence buyers. More than 78 percent of investors active in acquisition over $50 million said increasing interest rates do not motivate their decisions.

A large institutional investor noted that lots of institutions hold cash and don't need leverage to make the deal.

"A 25-basis point movement in interest rates, especially for unleveraged, or low leveraged investments, aren't going to make a difference. But as interest rates move even higher, and they will, there will be greater impact."

Large Institutional Investor

Conclusion

In spite of the challenges facing the retail market, Angelone, who advises clients in the acquisition and disposition of assets across the country, is optimistic about this property sector.

"It may be a bumpy five years, but that can induce great opportunities if you have vision and focus," he said. "The market will over-correct on value for certain assets. There will be opportunities."

While Hutensky is generally optimistic, he won't paint all of retail with the same brush. "Some markets and certain property sectors are doing better than others," he said. "Our fund focuses on value add open air retail in larger markets and avoids core properties and centers in secondary and tertiary locations."

Some investors noted that attractive investments, which are in great demand and will be acquired quickly, include so-called fortress malls; those centers that attract the best of the best tenants and truly define and/or cater to the overall shopping experience.

Steve Shanahan, Executive Managing Director of RCM added, "Our Retail Sentiment Survey responses show that investors continue to believe in the value of retail investments. Should the right opportunity come along, they won't hesitate to act quickly and decisively."

The RCM retail survey participants represented a wide cross section of principal investors, whose current investments include the following value ranges:

- Up to $20MM, 56 percent
- $20MM - $50MM, 25 percent
- $50MM - $100MM, 10 percent
- $100MM and above, 9 percent

About Real Capital Markets:

Founded in 1999, Real Capital Markets (RCM) is the global marketplace for buying and selling commercial real estate (CRE). RCM increases the speed, exposure, and security of CRE sales through its streamlined online platform. Solutions include integrated property marketing, transaction management, and business intelligence solutions that unify broker-level and firm-level data and work flows.

To date, the Company has executed approximately 50,000 assignments with total consideration in excess of $1.8 trillion. Over 50% of all U.S. commercial assets sold, over $10 million, are brought to market using RCM's online marketplace annually.

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