Retail Research
MARKET OVERVIEW
Marcus & Millichap

Phoenix Metro Area — *Third Quarter 2012*

Consumer Spending Rises as Housing Market Improves

After hitting bottom last year, retail operations will make positive strides in 2012, aided by an improving housing market that is restoring consumer confidence. Home prices climbed over 16 percent in the past year, recapturing some of the lost equity for the roughly 560,000 homeowners currently underwater. To assist these overleveraged borrowers, the FHA unveiled the Short Refinance Homeowners program to reduce up front refinancing costs. Additionally, the Home Affordable Refinancing Plan was revised by removing the loan-to-value limits, which allows underwater borrowers to refinance at a lower interest rate. As a result, home refinance closings are up 128 percent year to date, while future residents who utilize these programs could pocket hundreds of dollars each month. As households gain confidence in the recovery, many will spend the savings on nonessential items and dine out more often. This trend is most evident in the East Valley, where foot traffic at bars and restaurants has significantly increased. In downtown Chandler, for example, retailers are rushing to capture a slice of the robust spending, causing a shortage of available supply. Similar developments are prevailing throughout the metro as national and regional retailers cautiously re-enter the market. Quality space near transit hubs will garner keen interest, while unanchored strip centers in less-desirable areas will be backfilled at a slower pace.

With nearly $1.5 billion of retail inventory in some form of distress, sales activity will be dominated by REO and short sales. A large portion of the transactions will include strip centers purchased or refinanced during the height of the market with CMBS debt. As these loans mature, operators experiencing high vacancy will be unable to allocate adequate capital to cover the balloon payment. Most will be forced to short sale the property or face foreclosure. Investors with an established presence in the Valley will take advantage of these opportunities. After doing extensive due diligence, these buyers will rehab the property and market the space at a discount to garner tenant interest. Investors with short-term horizons will list the asset within five years to maximize upside potential, while others may refinance once the space is 80 percent occupied to buy another value-add property.

2012 Annual Retail Forecast

2.4% increase in total employment

Employment: The employment picture will brighten over the remainder of the year as the business-friendly environment in Phoenix attracts companies to the area. As a result, the metro's work force will expand by 41,000 positions in 2012, marking growth of 2.4 percent. Last year, 28,600 jobs were generated.

750,000 square feet will be completed

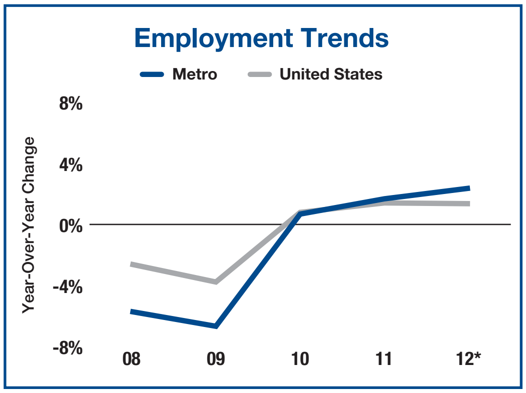
Construction: Development will reach a three-year high by the close of 2012 as 750,000 square feet of retail space will be completed in the metro, boosting supply levels by 0.5 percent. In 2011, just over 390,000 square feet came online in Phoenix.

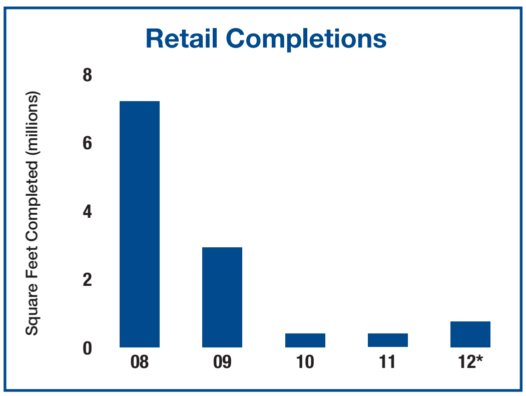
90 basis point decrease in vacancy

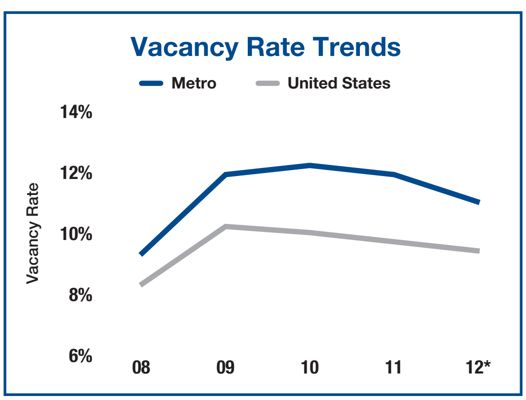
Vacancy: Solid demand and fewer store closures will support a 90-basis point reduction in vacancy this year to 11 percent, representing the lowest level since early 2009. In the preceding 12 months, vacancy dropped 30 basis points as tenants took down 840,000 square feet.

0.8% increase in asking rents

Rents: As vacancy falls to a three-year low by year end, landlords will gain sufficient leverage to bolster asking rents 0.8 percent in 2012 to $18.24 per square foot. Effective rents will follow the same pattern, growing 1.1 percent to $15.33 per square foot. The trend reverses the 0.5 percent and 0.6 percent reduction of asking and effective rents recorded in 2011.







* Forecast

Economy

- Supported by growth in most of the major employment sectors, Phoenix gained 20,400 jobs year to date, which is equivalent to a 1.2 percent increase. In the previous six months, companies added 19,300 staff to payrolls. The year-over-year gains helped tighten the jobless rate 160 basis points during that time to 7.5 percent.

- Job growth in the construction industry outperformed most of nation in the past six months, trailing only Houston. Supported by the uptick in apartment development taking place, the sector expanded by 3,740 new jobs, reflecting a 4.5 percent surge. Conversely, the only industry to cut jobs in the first half was the information sector, which lost 500 positions.

- Intel recently broke ground on a $300 million research and development facility at its Chandler campus to help grow the company's packaging operations. In addition to the $5.2 billion Fab 42 plant under way, the 285,000-square foot building represents another massive capital investment in Chandler by the chip maker. The space will come online by mid-2013 and employ hundreds of workers.

- **Outlook:** The metro's work force will expand by 41,000 positions in 2012, marking growth of 2.4 percent. Last year, 28,600 jobs were generated.

Construction

- Since the second quarter of 2011, a total of 560,000 square feet of retail space has been completed, enhancing the metro's supply levels by 0.3 percent. A large portion of the layouts consisted of mostly single-tenant space, including the 148,000-square foot Walmart and a 50,000-square foot LA Fitness.

- As the economy slowly improves, builders have resuscitated stalled projects in the last year as an aggregate 1.1 million square feet is under construction in the Phoenix metro, with delivery dates reaching to the end of 2013.

- The planning pipeline is extensive with 13 million square feet. The Mesa/Chandler/Gilbert submarket could receive 2.5 million square feet, while another 2.2 million square feet is slated for the North Scottsdale/Paradise Valley submarket. However, no construction schedules have been released.

- **Outlook:** For all of 2012, 750,000 square feet of retail space will be completed in the metro, boosting inventory levels by 0.5 percent.

Vacancy

- Limited new supply and firm demand contributed to positive net absorption of over 1 million square feet so far this year as owners were able to backfill empty space. As a result, vacancy fell 50 basis points to 11.4 percent, which mirrors the trend recorded in the previous six months.

- In the last year, demand picked up for all asset classes, with vacancy at community centers falling 50 basis points to a two-year low of 10 percent. At neighborhood centers, vacancy slid 70 basis points from a year ago to 12.4 percent.

- Demand for community center space accelerated in the Tempe/South Phoenix submarket over the last year as vacancy declined 170 basis points to 6.2 percent, representing the lowest level since mid-2009.

- **Outlook:** Vacancy will tighten 90 basis points in 2012 to 11 percent, after slipping 30 basis points in the prior year.

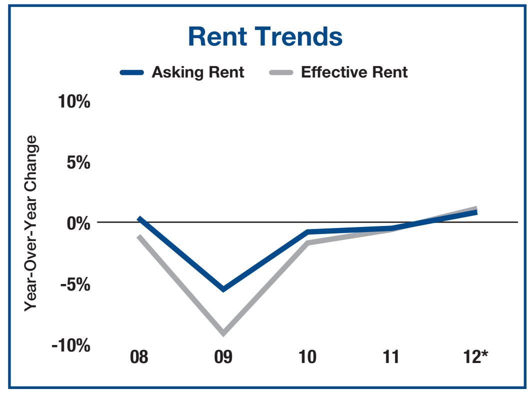
Rents

- Firm leasing activity and limited new competition allowed landlords to raise asking rents 0.3 percent in the last two quarters to $18.16 per square foot. At the same time, effective rents inched up 0.5 percent to $15.25 per square foot. In the latter half of 2011, asking and effective rents each slid 0.1 percent.

- Modest demand and the lowest vacancy in the metro prompted owners in the Central/Northeast Phoenix/South Scottsdale submarket to enhance asking rents 1.4 percent to $20.23 per square foot. Effective rents also rose 1.4 percent to $16.97 per square foot.

- As occupancy and effective rents both recorded gains in the past four quarters, owners captured a 1.5 percent increase in revenues. Additionally, leasing incentives were slightly down at 16 percent of asking rents in the second quarter.

- **Outlook:** Landlords will boost asking rents 0.8 percent in 2012 to $18.24 per square foot. Effective rents will grow 1.1 percent to $15.33 per square foot.



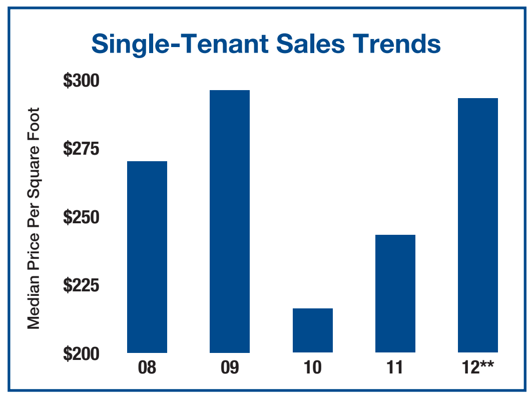
Single-Tenant Sales Trends**

- The low interest rate environment and attractive yields in the single-tenant asset class supported a 30 percent increase in transaction activity over the last 12 months. Buildings occupied by fast-food restaurants and freestanding properties accounted for a significant amount of the deals.

- The robust investor demand and lack of single-tenant product bolstered the median price over 20 percent from a year earlier to $293 per square foot. A few fast-food buildings occupied by a franchisee traded above $600 per square foot.

- Despite sales velocity spiking in the past year, cap rates held firm near 8 percent. Buildings net leased to Walgreens for 10 years or longer captured initial yields below 7 percent, while Dollar General traded in the mid-8 percent area.

- **Outlook:** Paultry yields in the bond markets and the overall safety of the single-tenant asset class will support intense demand for this product type. Buyers can capture returns near 7 percent on buildings net leased to a corporate tenant, which is a 300-basis point premium compared with the average corporate bond yield.



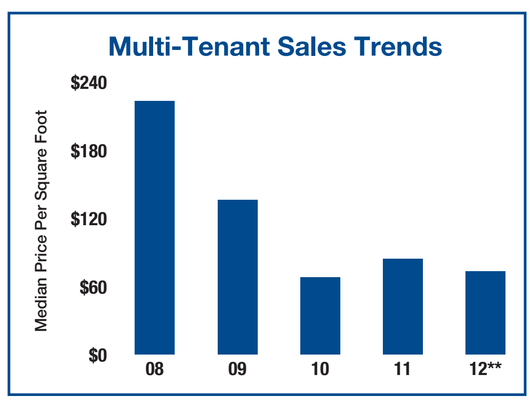
Multi-Tenant Sales Trends**

- Multi-tenant sales activity rose 23 percent year over year as opportunistic buyers purchased bank-owned neighborhood and strip centers for value-add plays. Additionally, institutions bought the limited supply of Class A shopping centers listed.

- Due to the influx of highly vacant centers trading in the last year, the median price fell 13 percent to $73 per square foot. Class A assets commanded over $200 per square foot, while older, distressed properties sold below $50 per square foot.

- Multi-tenant cap rates averaged in the mid-8 percent range, which is 120 basis points below the average last year. Distressed strip centers generated double-digit returns, while Class A shopping centers traded slightly below 7 percent.

- **Outlook:** Institutions seeking higher yields and lower price points may enter the Phoenix market and target newer, anchored shopping centers with a nationally recognized tenant. After maturing debt forced the previous owner to relinquish the property to the bank, these qualified buyers can leverage the asset to boost returns. Generally, cap rates for these properties average below 7 percent.



* Forecast
** Trailing 12-Month Period
Sources: Marcus & Millichap Research Services, CoStar Group, Inc., Real Capital Analytics

Capital Markets

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

- Limited retailer expansions are supporting a sluggish recovery in the national retail sector. Nationwide vacancy was unchanged in the first half at 9.7 percent, while asking and effective rents rose nominally. Additional store openings related to holiday shopping will modestly accelerate demand by year end, resulting in a 30-basis point vacancy reduction to 9.4 percent.

- In general, decent leverage is available to financing purchases of multi-tenant and single-tenant net-leased properties. For each property segment, LTVs typically start at 65 percent for nonrecourse loans and can range up to 75 percent depending on deal merits and recourse provisions.

- CMBS lenders offer terms of seven and 10 years on multi-tenant assets, and rates from 300 to 350 basis points above U.S. Treasurys. Many conduits have shown greater willingness to finance unanchored properties and assets with lower-rated anchors. For shopping center loans under $5 million, banks remain a primary lender and offer rates in the high-3s to low-4s for terms of three to five years, low- to mid-4s for sevens and high-4s to mid-5s for 10 years.

- Lenders focusing on STNL assets are underwriting specific merits of each property. Terms vary from five to 10 years, with spreads ranging from 240 basis points to 300 basis points over U.S. Treasurys. Walgreens' recent strategic partnership with Alliance Boots, a European pharmacy chain, has resulted in a lower credit rating and elevated caution among lenders.

Submarket Overview

- The Tanger Factory Outlet Center is under way at the Westgate City Center in Glendale. The 330,000-square foot center will come online during the fourth quarter, increasing inventory in the area by 2.4 percent. The economic output from the center will be a major boon for Glendale, with the creation of up to 900 retail jobs as well as $2.6 million in city sales taxes generated annually.

- Construction recently started on the Mesa Light Rail Expansion. The project will add just over three miles of track and four additional stops in downtown Mesa, giving passengers access to restaurants, museums, and shops. Once complete in 2015, an estimated 10,000 passengers may ride the train daily.

- After four years of setbacks, builders finally broke ground on the 173-room Marriot hotel earlier this year in downtown Tempe. Construction should be completed by early 2014, and boost foot traffic around Mill Avenue.

Submarket Vacancy Ranking

Rank	Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Effective Rents	Y-O-Y % Change
1	Central/NE Phoenix/South Scottsdale	8.3%	-20	$16.97	1.4%
2	Tempe/South Phoenix	9.7%	-120	$15.71	-0.5%
3	West Phoenix/Southwest Valley	11.2%	0	$11.46	0.8%
4	North Scottsdale/Paradise Valley	11.3%	-150	$19.50	-0.4%
5	Northwest Phoenix/Glendale	12.1%	-100	$13.72	0.1%
6	Mesa/Chandler/Gilbert	12.9%	-130	$14.23	1.1%

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