Real Estate Market Intelligence 2016

Benesch
Attorneys at Law

Retail Development Quarterly Report–Q1

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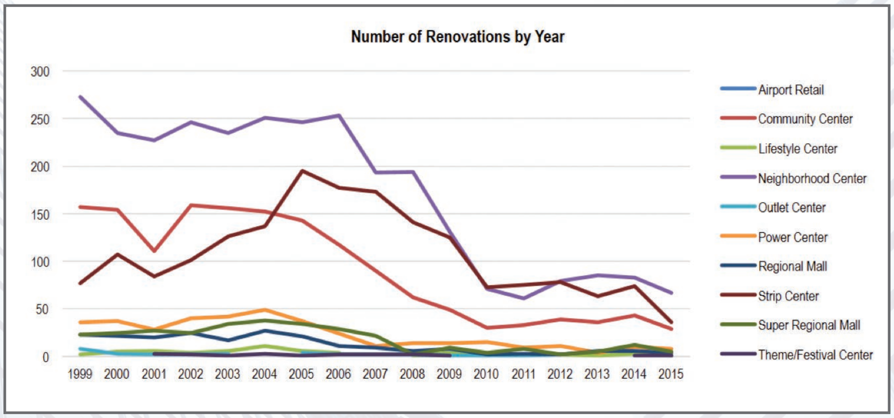
1. Key Findings

The U.S. retail sector remains commercial real estate's most sluggish sector, partially due to robust building during the 2000s, which left a hangover of space, and partially because the U.S. recovery hasn't meant robust wage gains. Thus the slow improvement for the property sector continued in early 2016, according to Reis Inc.'s 1Q 2016 report on the sector.

Neighborhood and community center vacancy was unchanged during Q1, at 10%. Retail mall vacancy was also unchanged for the quarter, but at a lower level: 7.8%. For both subsectors, supply and demand were roughly equivalent during the first quarter. Asking and effective rents for neighborhood and community shopping centers did manage some growth, up 0.5% and 0.6%, respectively, during the quarter. The growth rate for both types of rents have been more-or-less constant since Q4 2014.

New completions for neighborhood and community centers remain mired at low levels, with approximately 1.6 million square-feet coming online during the first quarter, the lowest quarterly figure since Q1 2014. Net absorption of 2.5 million square feet was slightly ahead of the figure from Q4, though demand for neighborhood and community center space remained limited.



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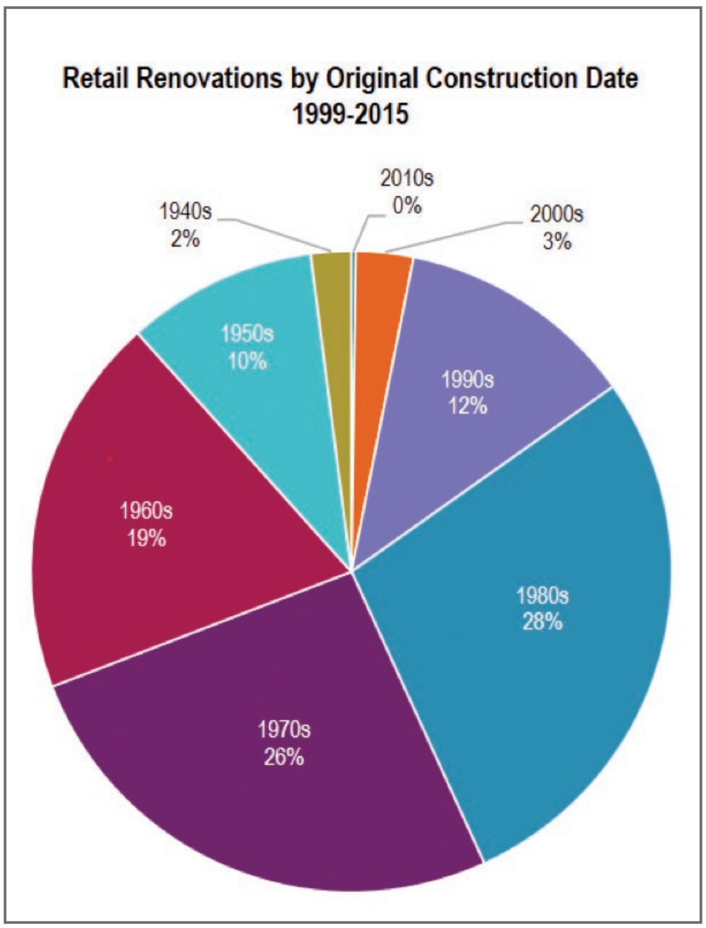
1. Key Findings *(continued)*

While retail construction remains at relatively low levels compared to previous cycles, there is currently 70 million square-feet of new shopping center space under construction across the U.S., which is the highest level since the most recent recession. Although the list of new retail projects includes 21 malls and five outlet centers, only 10 power centers are under construction, considerably less than in previous cycles. However, 86 grocery-anchored neighborhood centers under construction represent a significant increase from the last couple of years, reflecting the growing strength of smaller independent in-line tenants.

The increased confidence in grocery-anchored centers also reflects growing economic strength at the local level as the effects of the economic recovery continue to spread. In somewhat of a change in pattern from the previous retail supply boom from 2006 to 2008 and earlier, developers do not appear to be focusing on building new shopping centers in far-out suburban locations in the path of anticipated housing and population growth. Instead they are targeting more urban mixed-use infill projects, particularly in such supply-constrained markets as New York City, Miami and Honolulu.



2. Quarterly Transactions

Phillips Edison

- Phillips Edison Grocery Center REIT II acquired Lakewood City Center, a 67,280 square-foot retail center anchored by a 39,400 square-foot Marc's grocery store in Lakewood for $12.3 million.
- Phillips Edison Grocery Center REIT II purchased four grocery-anchored shopping centers in Colorado, Florida and California. The centers collectively comprise 305,422 square feet of retail space. Financial terms were not disclosed.
- Phillips Edison Grocery Center REIT II and TPG Real Estate formed a partnership to acquire grocery-anchored shopping centers throughout the U.S. The partnership will invest up to $250 million of equity and plans to leverage this capital to achieve a $750-million acquisition target. The partnership initially will acquire six grocery-anchored shopping centers.

Transactions in Ohio

- SRS Real Estate Partners brokered the sale of a 10,582-square-foot retail property net leased to Champps Americana Restaurant in Columbus for an undisclosed amount. Pickerington Square purchased the property, which is an outparcel to a power center.
- Forest City Realty Trust completed the sale of the Avenue at Tower City Center, a 366,000-square-foot retail center in Cleveland, Ohio, to subsidiaries of Bedrock Real Estate Services. The sale price was $56.5 million.
- Regency Properties purchased East Pointe Plaza, a 70,882-square-foot shopping center in Bucyrus, for an undisclosed price. The property is Regency's first acquisition in Ohio. The center is 96% occupied. The acquisition also includes two out-lots with road frontage available for future development.

Other Transactions

- Viking Partners Fund III acquired Clawson Center, a 130,424-square-foot, grocery-anchored retail shopping center located in Clawson, Michigan, for an undisclosed amount. The transaction represents the first acquisition for the Fund III portfolio in Michigan.
- Cedar Realty Trust acquired The Shoppes at Arts District in Hyattsville, Md., for $20.5 million, which includes the assumption of $8.5 million in fixed-rate debt. The two adjacent buildings form a 35,676-square-foot retail location.
- MGM Resorts International's JV with Dubai World's Infinity World Development agreed to sell 324,000 square-feet of retail space in the CityCenter complex in Las Vegas for $1.1 billion to a partnership between Invesco Real Estate and Simon Property Group.
- Hilliard-based U.S. Properties Group purchased The Streets of Indian Lake, a 249,121-square-foot retail development in Hendersonville, Tenn., for an undisclosed amount. USPG now owns approximately 4 million square-feet and redevelops shopping centers in 11 states.

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2. Quarterly Transactions *(continued)*

- A Chicago venture paid $139 million for 48 single-tenant retail buildings, including seven in the Chicago area. BlueRoad Ventures purchased the portfolio from Brauvin Net Lease, a privately held REIT managed by Brauvin Real Estate. This is the first acquisition for BlueRoad, an asset management and investment firm launched in 2015.
- CityView Commercial, a New York City commercial real estate firm, purchased the Palmer Park Mall in Pennsylvania for $18 million from Pennsylvania Real Estate Investment Trust. PREIT placed Palmer Park Mall on the market in 2015, along with three other mall properties, as it focuses on its highest-performing shopping centers.
- Pennsylvania Real Estate Investment Trust sold two malls in Alabama and one in Virginia to a fund managed by Farallon Capital Management, and sold the Lycoming Mall in Pennsylvania to Kohan Retail Investment Group. The combined price was $92.3 million. Joseph Coradino, who launched the sales effort soon after he took over as CEO of PREIT in 2012, said the malls hurt the company's image with investors and retailers.
- Inland Real Estate Corporation announced that funds managed by DRA Advisors completed their acquisition of the company, in a transaction valued at $2.3-billion, including the assumption of some debt. Going forward the entity will be known as IRC Retail Centers.

3. Retail REITs

Regional Mall REITs

CBL & Associates Properties – the fourth largest shopping mall REIT in the U.S., owns, holds interests in, or manages 130 properties including 79 market-dominant enclosed malls and open-air centers. CBL is an active developer of new regional malls, open-air centers, and lifestyle and community centers.

General Growth Properties is focused exclusively on owning, managing, leasing and redeveloping high quality retail properties throughout the U.S.

Macerich is the third-largest owner and operator of shopping centers in the U.S.

Pennsylvania Real Estate Investment Trust (PREIT) owns and operates over 26 million square-feet of retail; focusing on shopping centers in the eastern U.S., particularly in the mid-Atlantic. PREIT changed its strategic focus from a diversified property base to retail.

Simon Property Group – ranked #1 in the U.S. as the largest REIT, operates from five retail real estate platforms: regional malls, Premium Outlet Centers, The Mills, community/lifestyle centers and international properties. It currently owns or has an interest in more than 325 properties comprising approximately 241,000,000 square-feet of gross leasable area in North America and Asia.

Taubman Centers – an owner of regional malls in the U.S., has a portfolio of malls with the highest sales per square foot of any mall company in the U.S. Most of the malls developed by Taubman have a similar interior design.

Rouse Properties – is focused on management, redevelopment, repositioning, and acquisition of Class B regional malls. Rouse Properties owns 35 malls in 22 states encompassing approximately 24.5 million square-feet of retail space.

WP Glimcher – a multi-faceted REIT with a portfolio of 119 shopping centers, including enclosed regional malls, open-air lifestyle centers and community centers. Glimcher specializes in the ownership, management and development of retail shopping centers throughout the U.S.

Shopping Center REITs include: Acadia Realty, Brixmor Property Group, Cedar Realty, DDR, Kimco Realty, Ramco-Gershenson Properties, Regency Centers, Tanger Factory Outlet Centers and Whitestone.

Free standing REITs include: American Realty Capital Properties, National Retail Properties and Realty Income.

4. Market Overview

Shopping-center REITs on the list of many investors

Landlords are thriving with properties often seen as suburban eyesores, such as strip malls and shopping centers. While economic uncertainty clouds the outlook for many businesses, owners of open-air retail space have received a relative boost because their tenants often include grocers, discount-clothing stores and pharmacies.

With the lukewarm economy limiting construction of new space, retailers are showing steady demand for many existing properties, and occupancy is running high. Share prices of REITs that own billions of dollars' worth of strip malls and shopping centers reflect the favorable conditions. Many shopping-center REITs are up roughly 2% to 4% this year due to the limited supply and the ability to push rents.

Regional malls receive much of the attention from shoppers and retailers, but open-air shopping centers make up a far greater share of America's total retail square footage. They can range from small properties with two or three local merchants to large properties occupied by national brands. According to the International Council of Shopping Centers, new space at such centers has been growing less than 1% annually in recent years.

Developers also are wary of building new shopping centers because new homes aren't being built at a rapid clip in suburban areas where this kind of retail space thrives. To take the risk of building in a slow-growth economy, developers and lenders generally need a commitment from an anchor tenant to occupy the new space and anchor tenants are not expanding at the same rate they have in the past. The scarcity of new space can put owners of existing properties in desirable locations in a relatively strong position if vacancies arise.

Freestanding retail REITs expected to continue outperformance

Freestanding retail REITs are likely to remain market outperformers as long as the broader macroeconomic outlook remains uncertain. As of Feb. 19, returns for freestanding retail REITs were 14.5% higher year-to-date. That compares with a 5.9% decline in returns for the FTSE/NAREIT All REIT Index. Freestanding retail REITs are also finding that the acquisition landscape is working in their favor.

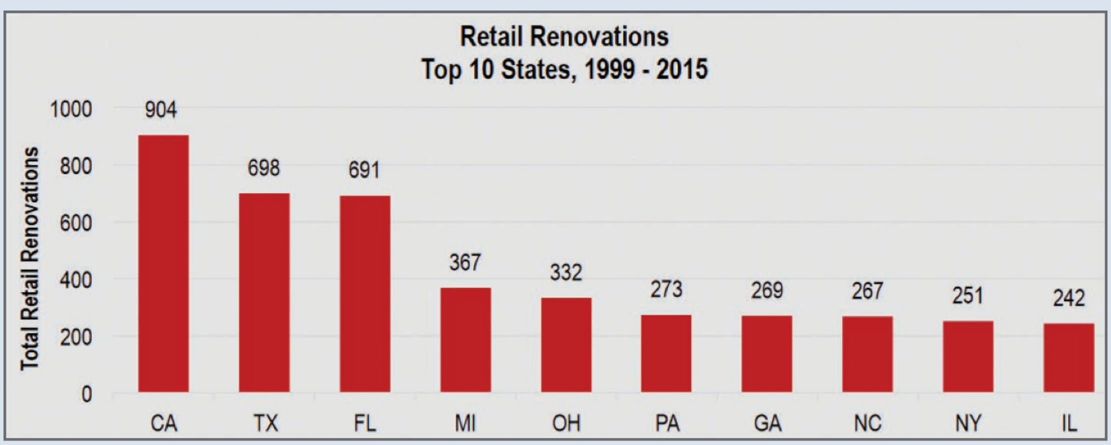
Much of the attraction of freestanding retail REITs can be attributed to investors looking for relative safety within the REIT sector. Investors recognize the durability of these dividends in various economic cycles. Furthermore, freestanding retail REITs that were public companies in the last recession lost very little occupancy. Today, they generally have stronger balance sheets than they had heading into the last recession.

Remaking Retail – Freestanding anchors & cities must be courted

Once an owner makes a convincing economic case for redevelopment, there are still more hurdles to clear; any one of which could spell the end of a would-be project. Anchor retailers often must give permission for the redevelopment, which could be a major hurdle for potential projects. These approvals may move quickly if all parties agree that a change is in order. However, if an anchor is currently meeting its sales expectations, it may be disinclined to disrupt the status quo. Anchors might also balk if they feel that the improvements will give a competing anchor a competitive edge or fear lost sales during the construction period, changes in the flow of foot traffic or movements in the primary points of ingress and egress.

Redevelopment may also alter parking ratios, which could prove a sticking point for an anchor or the municipality or even be prohibited by a reciprocal easement agreement. The local government may demand funds for infrastructure improvements necessitated by redevelopment. This could include new roads, the widening of existing roads or new traffic signals.

In the central business districts of top tier markets such as New York, Boston and Los Angeles, the dearth of vacant retail space has made it unlikely that these markets will be considered over-retailed any time soon. In fact, for retail property investors in core markets, the lack of properties for sale has led many to take another look at retail redevelopment. Investors appear to be making retail redevelopment a growing part of their strategies. They have had increasing difficulty in finding Class A retail assets for sale in major metro markets because the demand for such assets is so much greater than the supply. This has led many companies to explore potential expansion and redevelopment of existing assets. Many are now looking to buy non-retail assets near or adjacent to properties they already own, eyeing office buildings, land and even gas stations. These REITs are not necessarily interested in immediate redevelopment, but are rather thinking about setting the stage for future redevelopment or expansion.



5. Outlook—Trends to Watch

The retail sector will be forced to contend with ongoing bankruptcies and downsizing in categories that continue to struggle through various market influences. The fundamental health of the retail leasing market will remain largely intact. However, the impact of e-commerce and changing consumer behavior will result in a period of adjustment that will negatively impact performance. With e-commerce growing at a rapid pace, investors should be considering redeveloping their current properties to accommodate this wave. Traditional retailers are expanding their online presence, which may result in some shrinking of their physical stores. At the same time, more e-commerce retails are opening brick-and-mortar stores to boost their visibility and convenience to shoppers. Incorporating more warehouse space would be a beneficial alternative for mall owners to avoid vacancy rate drops.

As the demand for retail space increases and new retail construction decreases, landlords of shopping centers, power centers, strip malls, etc. should be able to increase rents as competition increases for prime spaces. Retail properties posted positive net absorption rates with asking and effective rents growing by 2% and 2.2%, respectively, during 2015. Current vacancy rates stand at 10% for 80 metropolitan U.S. markets, with an average rental rate of $20.09. The retail sector could see a 4% increase in rents in 2016.