

UNITED STATES HIGHLIGHTS



Brick-and-Mortar Retail Poised to Adapt in 2012

ANN T. NATUNEWICZ Manager, Retail Research | USA

MARKET INDICATORS

	Q4 2011	Q1 2012*
VACANCY	↔	↑
NET ABSORPTION	↑	↔
CONSTRUCTION	↓	↑
RENTAL RATE	↓	↔

*Projected, relative to prior period

- Retail real estate has a window of opportunity this year to refine and reassert its relevance, as many retail chains are still working out how physical locations fit into their multichannel strategies.
- Although Colliers doesn't expect an immediate barrage of liquidations/store closings, landlords must assume that most of their larger tenants (over 20,000 square feet) are considering smaller footprints, and be proactive with leasing, marketing, and property management.
- Cash-strapped consumers remain committed to finding "the deal," both in-store and online; retailers and landlords must find new ways get their attention and cement their loyalty.
- The quest for safety and yield drove 2011 investment strategy, but look for more risk-taking this year as cap rate compression and low inventory levels of core product force both institutions and individuals to broaden their exposure.
- Colliers Retail introduces nine themes and trends to watch in 2012, including strategic acquisitions, a renewed focus on limited edition and exclusive product, and big-box infiltration of urban areas.

With the natural exuberance of the holiday season in the rear-view mirror, we can now look toward 2012 with a clearer eye. Unfortunately, few signs suggest that this will be the year the economy turns a corner. Last year it became painfully obvious that many of the issues that precipitated the recession were structural, and they will continue to undermine the fragile recovery. U.S. households have made progress in deleveraging, but it will be at least another full year before consumer spending improves significantly. Corporate sentiment remains vulnerable to worries over Europe ripple effects, U.S. tax reform, the ongoing impact of regulations, and enhanced austerity measures. As spending power remains constrained, e-commerce will be this year's game-changer. Both the way products are offered and the way they are purchased (especially sales made on mobile devices and tablets) will continue to evolve at a dizzying pace. It's a transformative time for all aspects of the retail industry. The gap is widening between creative, nimble, and proactive companies and those lacking the vision or financial means to innovate.

Against this backdrop, retail sales and retail real estate are poised for another erratic year. As this report goes to press, it appears likely that the all-but-confirmed recession in Europe and ensuing global fallout will weigh on growth early in the year. Yet the likelihood exists for some upside later as inflation moderates, job growth and slightly looser credit standards spur consumer spending, and the manufacturing sector continues to strengthen. Alix Partners and the Economist Intelligence Unit (EIU) use the term "stingy growth" to describe their outlook for the next 12-36 months. While somewhat less applicable for better-positioned companies, it suggests that 2012 will be another year when competition for revenues, investment returns, and consumer loyalty are both hard-fought and hard-won.

U.S. RETAIL MARKET SUMMARY STATISTICS, Q4 2011

Vacancy Rate: **10.4%**
Change from Q3 2011: **-0.4%**

Net Absorption:
6.3 Million Square Feet

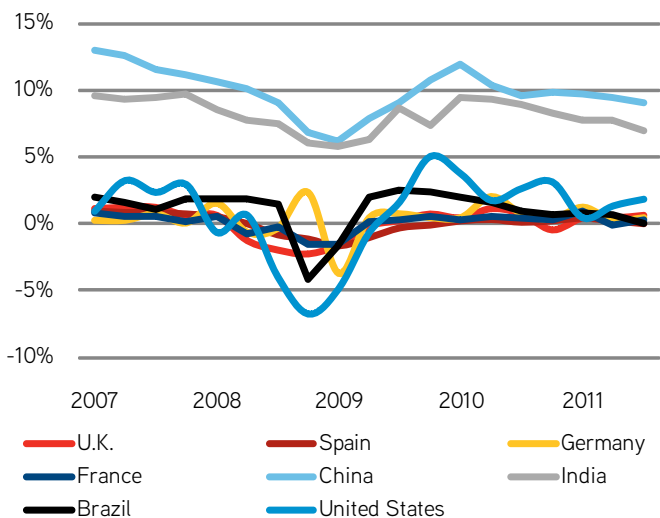
New Construction:
3.1 Million Square Feet

Under Construction:
3.3 Million Square Feet

Asking Rents Per Square Foot
Shopping Center Space: **\$15.51**
Change from Q3 2011: **Flat**

Source: CoStar

Percent Change in Quarterly GDP



Source: U.S. Commerce Department and www.tradingeconomics.com

Economic Recap

The Dow Jones Industrial Average (DJIA) ended 2011 at 12,217.56, up 5.6% from its 2010 close. Equities investors rode a roller-coaster all year: their ensuing flight to quality and safety pushed 10-year Treasury yields down more than 140 basis points to 1.89%, among their lowest levels ever recorded. So far in 2012, 10-year yields have bounced around the 2% mark as investor optimism on short-term growth remains muted.

Advance U.S. GDP data for the fourth quarter show the economy ended the year at a 2.8% annual growth rate versus a 3.0% estimate. For 2011, the U.S. expanded at 1.7%; 2010 expansion was 3.0%. Assuming no significant downward revisions, the Q4 data suggest that the economy recovered some momentum after nearly stalling out last spring/summer. Digging deeper into the numbers, though, most of the Q4 growth came from a build-up in inventory, which generally sets an optimistic expectation of future demand, but a draw-down of inventories slows GDP growth. The next several months will be telling: Was Q4 the next step in a tepid recovery, or merely the first of another burst of fits and starts?

EUROZONE CRISES THREATEN TO SPILL OVER INTO U.S.

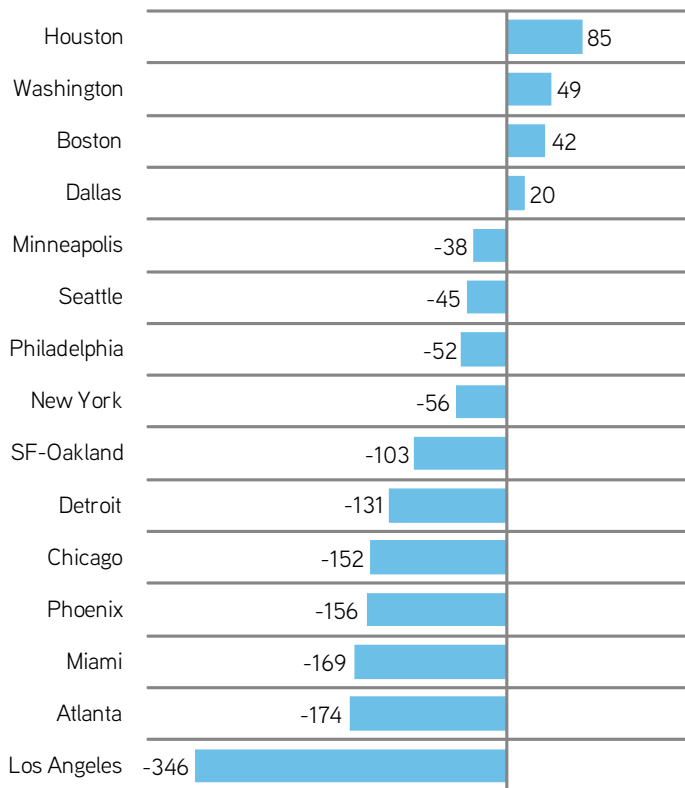
The Federal Reserve projects 2012 GDP growth will average between 2.2% and 2.7%, while consensus estimates late last fall put growth at 2%, slowed by 3–4 more years’ deleveraging yet ahead. Most private-sector opinions contained a big (read: optimistic) caveat that their numbers assumed that the Eurozone would not disintegrate. In the past month, both the World Bank and the International Monetary Fund (IMF) slashed their 2012 global and Eurozone outlooks. World Bank’s global forecast dropped from 3.6% to 2.5%, while the IMF was slightly more optimistic, moving from 4% to 3.25%. Both now have the Eurozone in a recession. Ensuing downgrades to European countries’ debt suggest that, at least in the near term, vigilance is essential. 2012 will be decisive for Europe; the markets are not likely to let this crisis extend into 2013.

U.S. financial institutions and policymakers remain on high alert, watching individual countries’ debt negotiations and the actions of the European Central Bank (ECB). With peripheral countries’ debt levels spiraling out of control, Europe in 2012 must decide whether to establish a more constrictive fiscal union that allows the ECB to institute structural reforms or allow a break-up—controlled or not. Both options will result in an extended period of austerity and pain for governments, financial institutions, and individuals. Greece has gotten much of the attention as it struggles to adopt a budget; the deadline for its next round of funding comes in late March. Even if Greece exits the Euro, larger economies such as Portugal, Italy, or France are next in line. Several major U.S. banks have significant exposure to European debt and could take writedowns in the event of defaults. The larger issue is the path and pace of the unwinding process, which will have longer-term implications for interest rate spreads, foreign exchange volatility, and the level of capital markets activity in general.

EMPLOYMENT GAINS IN PRIVATE SECTOR, LOSSES IN GOVERNMENT

The transition to private-sector job growth, offset by the first waves of job cuts in the public sector, was 2011’s biggest employment trend. As the

Metro Area Job Change Since 2007 (in 000s)



Source: Center for Regional Analysis, George Mason University

federal government continues to shed workers and programs, states and municipalities will accelerate their downsizing this year. These cuts will slow the growth rates of many metropolitan areas, including Washington, D.C., and strong state capitals, that have outperformed the rest of the country during the recession and recovery.

Hindered by government downsizing, the jobless rate is not expected to improve much in 2012 even if the employment picture improves. Momentum over the past several months is heading in the right direction (including January's 243,000 gain in nonfarm payrolls), but businesses remain unwilling to add staff despite achieving record corporate profits. Firms continue to substitute capital investment for labor, opting to make temporary cost-cutting programs permanent. Optimistic macroeconomic sentiment encourages unemployed workers to re-enter the workforce, which always moves the unemployment rate higher in the short term. The best opportunities for outsized employment growth lie with any concrete progress made either to tax reform (both corporate and personal) or specifics on new policies and programs related to health care. With more clarity on these two issues, business leaders should be more comfortable expanding their depleted payrolls.

Ahead of a broader recovery, the U.S. manufacturing sector grew steadily throughout 2011. In its most recent *Beige Book*, the Fed estimated that more new manufacturing and production jobs will be created this year than in any since 2006. Colliers believes the continued expansion of manufacturing—and job creation in secondary markets—will be one of 2012's bright spots.

SHADOW INVENTORY WILL PUSH OUT HOUSING RECOVERY

2011 ended with several upbeat reports on the U. S. housing market, renewing hopes that it may finally bottom out this year. Unfortunately, there remains no magic bullet to accelerate the resolution of unsold properties and shadow inventory. Existing home sales increased each month during Q4, ending the year at an annualized rate of 4.61 million units. Single-family starts also improved in December, up 4.4%, but the overall starts number sank 4.1% after multifamily starts dropped 20%. New home sales fell 2.2% in December to a seasonally adjusted annual pace of 307,000, their worst year since 1963. For the year, home prices declined 3.9% to an average of \$166,100, their lowest value since 2002, with limited—if any—real pricing improvement in any of the markets covered by Case-Schiller. Further downward pressure on prices is expected as banks finish working through legal issues within the foreclosure process and begin to push more homes into the market.

Although last week's mortgage deal is nowhere large enough to make a significant dent in negative equity, it is a start. Because consumers' sense of wealth is so closely tied to their equity position, any improvement will boost consumer spending. Excluding the contribution to spending made by shoppers drawing down their home equity lines, real consumption growth in the mid 2000s would have been around 2%—similar to the annualized rate in Q3 2011. Reversing negative equity is key to lifting retail sales, although growth will never match what happened earlier in the decade.

Despite the magnitude of the housing crisis, small improvements during the past year have generated enthusiasm among some long-term investors. In Q4, Blackstone Group and Goldman Sachs increased their stake in home builders Pulte, Beazer Homes, and Hovnanian. A recent Goldman report

predicted that home prices will decline an additional 3% percent in 2012 before gaining 30% —not factoring in inflation— through 2022.

Current Conditions

What follows is an overview of community center operating results for Colliers' U.S. retail markets, along with a short discussion of a few key trends we've been tracking this quarter that are impacting our national outlook.

The fourth quarter vacancy dropped 0.4%, from 10.8% to 10.4%. Looking ahead to the first quarter of 2012, we expect vacancy rates to tick up slightly, as retailers tend to close a larger percentage of marginal locations this time of year. The slightly improving economy may also give retailers more confidence to do so, as Wall Street analysts are less likely to interpret their decision as a sign of larger operating problems.

Western Michigan, Phoenix, Las Vegas, and Detroit all recorded year-end vacancy rates above 15%. Las Vegas vacancy registered a 30-basis point drop. For the full year 2011, vacancy rates improved by more than 100 basis points in Charleston (9.4%), Columbus (12.2%), Indianapolis (11.9%), Jacksonville (12.1%), Louisville (11.0%), Miami-Dade County (5.0%), Nashville (9.7%), Oakland/East Bay (6.1%), Palm Beach County (10.2%), Pittsburgh (6.6%), Reno (13.3%), and San Jose/South Bay (6.3%).

Fourth-quarter absorption tallied 6.3 million square feet, up from 5.1 million in Q3, and reached another two-year high. Houston and Denver led the country: each absorbed more than one million square feet. Other strong performers included Boston (+872,274 square feet), Greenville-Spartanburg (+798,369), Raleigh-Durham (+573,199), Dallas-Ft. Worth (+569,536), and Oakland-East Bay (+540,358). Four Florida metro areas—Tampa-St. Petersburg, Miami-Dade, Jacksonville, and Palm Beach County—also recorded strong numbers. At the other end, absorption rates in Northern New Jersey (-695,049), Fresno (-371,540), and Cleveland (-357,251) trailed the rest of the country.

Nationwide, the balance of power remains tilted toward tenants, with rents essentially unchanged even as vacancy rates ticked down. Looking ahead to the end of this quarter, we expect vacancy rates to increase for properties that signed on temporary tenants over the holidays, or those with retailers already slated to close in Q1. Although many metro areas still have elevated vacancy rates, as spring approaches we expect a larger number of new construction projects (particularly urban infill, anchored by a strong grocer) to break ground in supply-constrained markets.

UNITED STATES | SHOPPING CENTER MARKET STATISTICS

MARKET	INVENTORY* DEC 31, 2011 (SF)	NEW SUPPLY 2011 (SF)	UNDER CONSTRUCTION (SF)	VACANCY RATE		YTD ABSORPTION, 2011	QUOTED RENT DEC 31, 2011 (US \$PSF)	YTD CHANGE IN RENT (%)
				DEC. 31, 2010 (%)	DEC. 31, 2011 (%)			
Atlanta, GA	140,242,855	380,187	172,075	14.7%	14.9%	285,661	13.06	-3.19%
Bakersfield, CA	9,250,024	0	0	8.3%	9.4%	58,997	15.03	0.40%
Baltimore, MD	45,803,921	183,959	196,640	7.5%	8.2%	-33,704	18.55	0.32%
Boise, ID	13,342,117	8,000	8,260	12%	11.7%	9,909	11.69	-5.11%
Boston, MA	85,414,707	559,718	66,000	7%	7%	872,274	15.12	-5.26%
Charleston, SC	15,791,335	131,400	0	11%	9.4%	335,320	13.65	0.07%
Charlotte, NC	51,025,718	143,652	9,102	11.9%	11.6%	336,731	13.11	0.00%
Chicago, IL	160,552,131	373,660	11,683	12.4%	12.3%	50,400	15.68	1.29%
Cincinnati, OH	51,323,066	214,000	12,000	14.3%	12.8%	630,236	11.55	-2.58%
Cleveland, OH	58,010,908	34,191	6,000	12.4%	13.6%	-357,251	10.6	-7.83%
Columbia, SC	15,138,051	3,080	0	8.3%	9.1%	-22,000	10.81	-8.54%
Columbus, OH	30,916,140	92,414	3,200	13.6%	12.2%	253,890	12.57	3.20%
Dallas/Ft. Worth, TX	148,510,334	423,218	403,444	13.1%	14.2%	569,536	13.08	0.54%
Denver, CO	70,193,435	486,742	128,000	10.5%	9.6%	1,124,205	13.84	-3.69%
Detroit, MI	70,350,583	89,368	3,500	16.1%	15.6%	293,874	12.46	0.40%
Fresno, CA	24,864,662	0	14,820	11.2%	12.5%	-371,540	13.59	-0.51%
Ft. Lauderdale-Broward, FL	48,408,609	4,494	35,000	10.5%	9.9%	584,091	17.4	-0.06%
Greenville/Spartanburg, SC	29,411,611	269,795	39,300	11.9%	9.4%	798,469	8.93	-7.08%
Hartford, CT	42,510,990	158,529	17,052	8.6%	8.4%	156,809	13.32	-1.91%
Hawaii	17,150,665	0	0	4.1%	4.2%	20,088	31.77	-0.94%
Houston, TX	150,256,064	471,668	153,102	10.4%	9.5%	1,164,402	14.05	-1.13%
Indianapolis, IN	39,705,927	13,500	0	12.9%	11.9%	18,324	11.87	-0.08%
Jacksonville, FL	36,191,795	66,752	0	13.6%	12.1%	411,350	13.37	-3.12%
Kansas City, MO-KS	38,743,428	51,500	0	15.1%	14.2%	210,664	12.06	2.90%
Las Vegas, NV	50,304,545	7,730	3,600	15.4%	15.7%	310,373	16.94	-5.89%
Little Rock, AK	14,941,882	0	22,000	8.2%	8.8%	-63,902	9.63	10.82%
Long Island, NY	50,813,348	329,867	314,562	4.7%	5%	389,151	23.9	-1.28%
Los Angeles - Inland Empire, CA	86,128,552	97,519	172,496	11.6%	11.5%	82,592	18.31	2.46%
Los Angeles, CA	147,901,596	273,340	61,866	6.9%	6.8%	218,058	22.52	-5.77%
Louisville, KY	27,837,785	52,049	24,050	12.7%	11%	509,583	11.63	3.93%
Memphis, TN	30,443,926	9,099	150,000	12.5%	13%	-89,139	10.93	0.37%
Miami/Dade County, FL	45,050,523	114,341	0	6.5%	5.5%	538,124	22.11	0.09%
Milwaukee, WI	33,864,507	60,450	82,000	11.5%	11.9%	214,542	11.39	-7.55%
Minneapolis, MN	53,779,952	217,095	26,076	9.6%	9.9%	2,033	13.37	-3.26%
Nashville, TN	25,470,783	12,753	0	10.7%	9.7%	120,695	13.27	-3.00%
New Jersey - Northern	91,306,521	378,593	40,000	8.7%	10%	-695,049	19.45	-1.52%
Oakland/East Bay, CA	40,511,076	62,500	81,607	7.3%	6.1%	540,358	21.01	-5.91%
Oklahoma City, OK	26,753,164	69,056	0	11.2%	10.4%	210,496	9.82	-2.68%
Omaha, NE	16,492,336	27,849	5,031	12.1%	12.9%	-76,151	10.97	-4.94%
Orange County, CA	64,067,833	28,623	0	6.6%	6.9%	-48,829	22.68	-2.37%
Orlando, FL	62,678,877	152,286	0	11.8%	11.5%	268,847	14.93	-3.49%
Palm Beach County, FL	35,485,438	0	0	11.3%	10.2%	517,041	17.19	-3.64%
Philadelphia, PA	148,401,833	909,926	64,339	9.7%	9.7%	338,491	14.49	-0.21%
Phoenix, AZ	104,006,243	123,081	158,569	15.3%	16.4%	-126,135	14.00	-8.79%
Pittsburgh, PA	31,829,885	35,596	145,000	7.8%	6.6%	505,794	11.93	8.06%
Portland, OR	34,414,282	343,232	6,000	8.1%	8.2%	410,143	17.18	-6.32%
Raleigh/Durham/Chapel Hill, NC	38,204,213	510,665	4,209	8.9%	9.1%	573,199	15.72	3.76%
Reno, NV	9,980,529	0	0	14.6%	13.3%	17,531	15.37	-4.30%
Sacramento, CA	50,991,056	20,263	5,000	13.8%	13.7%	380,142	16.96	-5.46%
San Diego, CA	53,933,238	44,460	103,590	7.7%	7.6%	204,164	20.65	-3.59%
San Francisco, CA	9,592,251	47,476	0	438%	4%	140,125	27.4	-9.27%
San Jose/South Bay, CA	30,372,629	179,322	122,062	7.3%	6.3%	366,228	25.67	-5.10%
Savannah, GA	6,367,095	0	0	8%	8.8%	8,269	14.52	0.41%
Seattle/Puget Sound, WA	57,223,629	153,376	67,120	10.4%	10.3%	211,344	18.14	-1.25%
St. Louis, MO	54,262,677	233,834	45,243	11%	11%	111,929	12.65	1.04%
Stockton, CA	19,175,799	158,370	13,225	11.1%	10.9%	196,992	15.59	-0.19%
Tampa/St Petersburg, FL	86,428,485	181,456	35,932	11%	10.8%	703,378	13.28	-0.82%
Washington, D.C.	81,594,981	258,315	119,069	7.4%	7.5%	202,469	22.23	-0.71%
West Michigan	32,294,003	16,364	7,700	17.8%	17.4%	103,700	9.28	-2.11%
Westchester County, NY	50,451,503	87,628	150,000	6.4%	6.9%	-265,402	18.77	0.81%
U.S. Total/Average	3,196,466,051	9,356,341	3,309,524	10.7%	10.3%	14,431,909	15.51	-1.84%

*Community and Neighborhood Centers. Source: CoStar, Colliers Research

HOLIDAY 2011 AND THE 2012 CONSUMER

As expected, incessant promotional activity, led by Internet retailers, defined Holiday 2011. Depending on the forecaster and specific time period covered, holiday sales rose anywhere from 3.3% to 4.1% year-over-year: solid numbers, but slightly behind 2010. ComScore reported that during November and December, online shoppers spent nearly \$37.2 billion, up 15% from the approximately \$32.4 billion spent in 2010. Many retailers sacrificed margins to capture revenue and market share from competitors. Q4 earnings are revealing how that decision (combined with extended operating hours) hurt profits.

Despite increases in top-line retail sales, underlying trends portend continued consumer weakness and caution in 2012. Early last year, monthly total retail sales passed their prior peak (November 2007) and eventually ended the year at nearly \$401 billion in December. Sales gains came not from higher consumption, however, but inflation-driven higher prices, particularly on fuel. As gas prices began to moderate and consumers increased spending, the 2% rise in personal consumption during Q4 outpaced personal income growth. Shoppers funded holiday purchases by dipping into their savings and relying more heavily on credit cards. If income growth fails to keep pace with any future shocks to gas prices, shoppers could rein in spending and replenish their savings. On the other hand, if inflation moderates, then a slower sales growth rate could mask an increase in actual consumption. Weighing all these possibilities, the National Retail Federation (NRF) predicts that 2012 retail sales will increase 3.4% versus 4.6% in 2011; their forecast excludes sales of automobiles, gas, and restaurants. The International Council of Shopping Centers (ICSC) is forecasting 3% growth in 2012.

Look for accessories, electronics, and “small luxuries” to generate the strongest revenues in 2012. Sell-throughs are by no means guaranteed, though. Last month’s *Wall Street Journal* referenced shoppers’ “upgrade fatigue”: they’ll demand more functionality, not just tweaked branding, from a device before they’ll pony up to replace it. Consumers will continue to funnel money to service providers—anyone in the business of extending the life of a product (think auto mechanics, tailors, and plumbers) as they weigh repair costs against replacement. And, as negative home equity prevents them from selling their existing home, homeowners are choosing modest home renovations: The National Association of Homebuilders’ remodeling index recently reached its highest level in five years.

MOBILE EXPLODES INTO THE MARKETPLACE, ACCELERATING PRICE WARS

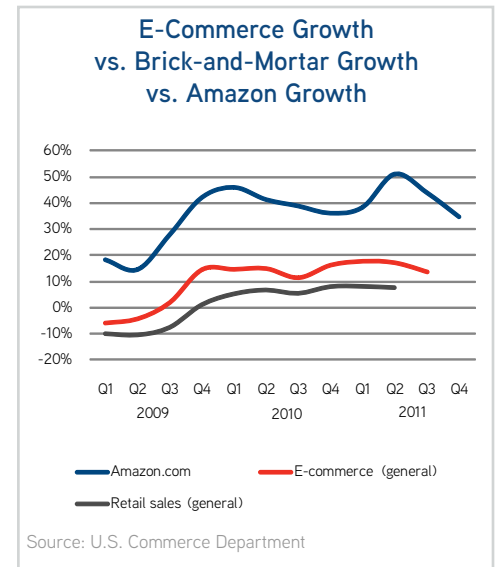
Mobile-phone commerce sales surged to \$6.7 billion last year, up roughly 90% from 2010. Forrester projects that mobile sales could reach \$10 billion in 2012 as smartphone penetration in the U.S. nears 50% and more people began to use retailer apps and phone-enabled websites for shopping. For many retailers, mobile is becoming the bridge between their Web and offline operations.

In the short term, mobile applications are escalating price competition. Shoppers now routinely stand in stores and compare prices offered by competitors in real time. A recent Prosper mobile survey tallied the sales leakage from these “scan and scam” shoppers: 40.6% of shoppers used a mobile device to compare prices while in a brick-and-mortar location, but only 30.6% went on to buy an item from the place they were. Aggressive discounting across retail categories and products has significant implications, although for discounting doesn’t ensure customer loyalty. Shoppers need a reason to come back.

RETAIL INNOVATION BECOMING MORE NUANCED

Recognizing this trend, retailers—even those in the discount sector—are reworking their branding and marketing to compete on “Experience,” of which customer satisfaction is the most critical component. Customer “hot buttons” include a desire for customized product offerings, detailed product information, merchandise availability, a convenient transaction/delivery experience, and flexibility in returns.

Innovation in each of these categories is occurring both online and in-store. Websites now must be easy to read and navigate on both desktop Web browsers and mobile devices. They frequently offer visitors the opportunity to enter their personal data to receive product recommendations, advice on assembling an outfit, most flattering styles according to body type, and alerts on future sales. At



Top Five* Mobile-Shopping Savvy Cities

1. Houston
2. New York
3. Atlanta
4. Los Angeles
5. Dallas - Ft. Worth

*Cities were ranked based on percentage of residents who owned a mobile phone, how likely they were to be influenced by mobile coupons, whether they own a mobile retail app, and whether they use social media apps.

Source: IAB Mobile Marketing Center, December 2011.

the store level, more retailers may begin using roaming salespeople—a *la* Apple—to answer product questions, check inventory levels (both in-store and at nearby distribution facilities), and shorten the check-out process. And then there's the physical store space itself: Retailers have launched a wave of new "concept stores" designed either to broaden or tighten their assortments (Coach) or revamp store design (Ann Taylor, Thomas Pink, Banana Republic). We could devote an entire paper to the creative ways retailers are adjusting their brands to capture and retain new customers. The winners here will be the ones who keep it simple and make the customer feel appreciated—the same strategy that has always worked for retail but at a more rapidly evolving pace.

MORE STORE CLOSINGS THAN 2011, BUT NO REAL ESTATE FREE-FALL

Store closings generate headlines, but not all are created equal. First-quarter closings typically spike as retailers shutter underperforming locations after holding them open over one final holiday. The challenge, as always, is to distinguish between store closings that are part of any healthy business, e.g. pruning unprofitable locations, and those that reflect either a weak retail concept or the early effects of cannibalization by Internet retailers.

On this list shown below, Sears/Kmart telegraphed the most negative outlook. CIT's decision to cease lending to Sears' vendors harkens worryingly back to Mervyn's decline. As that defunct chain demonstrated, once one source of factoring disappears it can trigger a chain reaction among other lenders and accelerate the downward spiral toward liquidation. The Sears closings threaten the viability of the properties they anchor. Many of them are located in tertiary markets, in properties that are already struggling, and with a narrow pool of replacement tenants to backfill so large a space. Sears may be the only viable anchor (or one of only two) and

occupy a large percentage of a property's total square footage. Sales transfer from a Sears closure benefits competitors, most likely JCPenney or Macy's, but will cripple the mall if it deadens a wing or triggers kick-out clauses for remaining national tenants. Sears' declining sales and mounting liquidity/solvency concerns have landlords, sales-tax-collecting municipalities, and CMBS investors on high alert for more bad news.

The other chain closings range from worrying to normal. Talbots, Coldwater Creek, and Christopher & Banks expanded rapidly in the past decade, only to see their core customer—the mature woman—shift spending away from apparel into things for her family or little luxuries for herself when the recession hit. The three chains' exposure to lifestyle center development, as well as inconsistent merchandising, suggests that further restructuring/refocusing is needed. Alternatively, Macy's/Bloomingdale's and Family Dollar are examples of retailers pruning their portfolios: the Macy's locations had underperformed for several years, and Family Dollar, while closing 80 stores in 2012, plans to open 500.

Looking ahead, we estimate 2012 chain store closing announcements will number around 5,000 locations: higher than the approximately 4,100 closings in 2011, but below 2010's 5,600 and 2008's 6,900. Colliers doesn't expect many portfolio liquidations, although prospects for Arden B's 86-store portfolio are weakening on a string of double-digit sales declines and competitors stealing its market share. Select closures appear likely at The Bon Ton (declining sales, recent debt downgrades, risks with new CEO), Best Buy (acknowledging the impact of online sales growth on its need for large stores), Pottery Barn (quietly closing stores in an uneven housewares sector recovery), and Olive Garden (continuing pressure on middle-market segment). Men's Wearhouse, although performing well, could also be considering store closures: It notched one of the highest year-over-year e-commerce growth rates while catering to a demographic segment not known for its love of the in-store shopping experience. Finally, we're also keeping an eye on retail banks, which added locations rapidly in the past five years. Their parent companies' larger financial difficulties may force some consolidation, and, with increasing adoption of online banking, consumers have fewer reasons to visit a bank branch.

E-commerce's upward momentum represents a seismic shift that ultimately will transform how retailers and landlords envision/execute their real estate strategy, and how investors arrive at retailers' valuations (which traditionally reflected their ability to add stores). In the meantime, physical stores are far from becoming obsolete. Recent holiday traffic to some of the biggest Internet-only retailers (eBay, Overstock.com, and Buy.com) lagged the websites of traditional retailers including Walmart, Best Buy, Target, and Apple. Those with a vested stake in real estate should take comfort that retail continues to demonstrate that the value of a brand can drive traffic and generate sales across channels.

HOW TO FORECAST THE REAL ESTATE TIPPING POINT?

Retailers are operating with stronger balance sheets than they were five years ago. What's less transparent in their financials is the internal value they place on their real estate as a distribution channel, and how their individual strategies are evolving. The elephant in the room, not only for landlords but the entire industry, is the projected gradual decline in demand for retail real estate, and how to predict when a retailer will consider downsizing.

SELECTED STORE CLOSINGS ANNOUNCED IN Q4 2011

RETAILER	# OF CLOSINGS	% OF EXISTING U.S. STORES
Christopher & Banks/CJ Banks	69	13
Coldwater Creek	35-40*	10
Espirit	93	100
Family Dollar	80	12
Famous Footwear	105	10
Food Lion/Bloom/Bottom Dollar**	146	10/100/14
Lowe's	20	1
Macy's/Bloomingdale's	9	1
Old Country Buffet	81	16
Sears/Kmart	100-120	3
Syms/Filene's Basement	46	100
Talbots	83	14
The Gap	90-100*	20

* During next 2 years

** Bottom Dollar still adding several hundred stores in next the five years

Sources: ICSC Research & PNC Estate Research, company web sites, Colliers analysis

Harvard Business Review published a study in December that calculated the real estate “tipping point” occurs when a retailer’s online channel contributes 15% of total sales. HBR cited Borders’ trajectory of decline and predicted that many apparel retailers could reach that level within five years. Very few multichannel retailers break out sales between in-store and online, though, complicating the forecasting process.

Unless retailers’ financials become more transparent with respect to online sales penetration, landlords must remain vigilant and proactive. No fewer than 50 retailers tracked by Colliers have announced that they are either testing or launching smaller prototypes. It’s a safe bet that any retailer larger than 20,000 square feet is re-evaluating its real estate portfolio. Trying to identify vulnerable locations is challenging, but landlords can reverse the process that retailers undertake when they open new locations. On a national basis, vulnerable areas can be identified by understanding which metro areas are oversaturated with retail (on a square footage per capita basis) and overlaying them with those weakened by housing market troubles and low (or negative) projected job growth in the next decade. At a more granular level, predictions involve monitoring earnings, liquidity ratios, changes in how capital expenditures are allocated between real estate and technology platforms, and the speed of digital penetration among merchandise categories and consumer cohorts.

While we acknowledge that online retail will eventually render a significant number of retail locations obsolete, we assert that landlords are not powerless. In fact, both landlords and retailers have a huge opportunity this year to refine and reassert the value of their portfolios through leasing, marketing, and property management. Those with national portfolios can assist retailers with multichannel integration, coordinating messaging on new store openings, promotions, and events. They can also facilitate retailers’ ability to offer online fulfillment at brick-and-mortar locations by being flexible with operating hours and managing parking fields to enhance the customer convenience factor. For retailers seeking to elevate their in-store brand experience, landlords can work with them to enhance the connectivity of their leased space, which may require larger-scale facilities upgrades to technology, and rethink how tenant improvement costs are allocated. For retailers that insist on downsizing their space, there may be opportunities to sublease to complementary uses that enhance the retailer’s brand and generate replacement cash flow to the property owner. Reworking the landlord-tenant relationship won’t prevent every retail vacancy in the next five years, but a stronger partnership ultimately leads to a happier consumer, which benefits everyone in the end.

UP ON THE HILL

In our opinion, the Supreme Court decision on the constitutionality of health-care reform legislation (Affordable Care Act) will be one of 2012’s top news stories, regardless of the outcome. The high court will hear more than five hours of oral arguments—the most in more than half a century—beginning in late March, and is expected to deliver its ruling before the Fourth of July. If it strikes down any part of the bill, the court could end significant uncertainty cited by corporate leaders for postponing investment, including new hiring, in their businesses.

Brick-and-mortar retailers are moving closer to closing the sales tax loophole currently enjoyed by Internet and catalog sellers. In November 2011 the Senate introduced the Marketplace Fairness Act, which would facilitate states’ collection of sales tax from online retailers, particularly on interstate transactions. Even in a contentious election year, the legislation appears to have sufficient bipartisan support to advance in the Senate. Concurrently, four states—California, South Carolina, Tennessee, and Indiana—have reached individual agreements with Amazon.com to initiate tax collection.

At the state level, California’s recent decision to abolish its redevelopment agencies has rocked the real estate world. On February 1st, agencies were required to surrender all

SELECTED RETAILERS OPENING 40+ LOCATIONS IN 2012

RETAILER	CATEGORY	ESTIMATED OPENINGS
Fossil	Accessories	50
Ann Taylor	Apparel	80
Cato	Apparel	50
Foundry Big & Tall (by JCPenney)	Apparel	75
Gap Outlet	Apparel	50-60
Lululemon	Apparel	58
Advance Auto Parts	Auto	140
AutoZone	Auto	160
O’Reilly’s Auto Parts	Auto	150
Pep Boys Auto	Auto	75
Bed Bath & Beyond	Big Box	70
Big Lots	Big Box	90
Lowe’s	Big Box	40
Party City	Big Box	60
Five Below	Discounter	50
TJX Cos.	Discounter	116
Walmart (total)	Discounter	215-235
Dollar General	Dollar	625
Family Dollar	Dollar	500
CVS	Drug	250-300
Rite Aid	Drug	100
Walgreens	Drug	150-175
Best Buy (total)	Electronics	140
Arby’s	Fast Food	100
Burger King	Fast Food	250
Chick-Fil-A	Fast Food	60
Chipotle	Fast Food	155-165
Dunkin’ Brands	Fast Food	200
Hardee’s	Fast Food	100
KFC	Fast Food	350
McDonald’s	Fast Food	100
Panera	Fast Food	115
Starbucks	Fast Food	100
Taco Bell	Fast Food	175
Wendy’s	Fast Food	65
Aldi	Grocer	80
Ulta	Misc.	60
Buffalo Wild Wings	Restaurant	80
Denny’s	Restaurant	75
Golden Corral	Restaurant	40
Pizza Hut	Restaurant	350

Source: Retail LeaseTrac, RBC Capital Markets, PNC Market Research, retailer websites, Colliers proprietary data

assets to successor entities, which will then honor contracts made prior to January 1, 2011, but liquidate everything else in their possession. The January 2011 deadline is significant because the decision gives the state the right to either negate agreements or “claw-back” property transfers made since then, setting the stage for protracted legal battles between cities and the successor entities. The state justified the decision in light of its huge budget shortfall, but critics are decrying the devastating effects the new policy will have on public-private partnerships.

The Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) continue moving toward convergence in their treatment of lease accounting. Proposed rule changes, up for discussion in 2012, would eliminate the test that distinguishes between capital and operating leases. If the rules change, all leases would have to be accounted for on the balance sheet (currently, operating leases can be held off the balance sheet). This rule change would add more than \$1.3 trillion of operating lease obligations to corporate balance sheets, and dictate massive changes to real estate strategy for companies with a large number of real property leases.



GROCERY

In our third quarter retail report, we predicted that marginal grocers would be vulnerable to store closings in the next couple of years. Since then, Food Lion announced that it will close 113 underperforming stores as it shifts its corporate energy to expanding its Bottom Dollar brand. It's the same story that's being played out throughout the industry. Middle-market chains are being squeezed by rapid expansion of both discount chains relatively new to the food game (drugstores and dollar stores) and high-end operators such as Whole Foods, Wegmans, and Trader Joe's. PNC's recent *Retailer Productivity Report* cited grocery chains as one of only three retail categories that experienced a decline in average sales per square foot in the past year. As older, weaker stores close, they hurt not only property-level vacancy and cash flows but also the health of strip center property loans bundled into CMBS tranches.

Grocers are investing significantly in store remodeling that will occur during the next couple of years. Proposed programs include improving lighting and flooring, creating more flexible spaces to market groups of

products together, and reallocating square footage to categories and departments more aligned with wellness initiatives. There also appears to be renewed interest in on-line shopping, despite limited prior market penetration of concepts such as Peapod. Piggly Wiggly and Harris Teeter are among the handful of chains conducting small-scale experiments with their capacity to fulfill online orders on select markets.

RESTAURANT

The National Restaurant Association predicts that total restaurant sales will increase 3.5% over last year, to a record high of \$632 billion, as lower costs for some commodities allow restaurant operators to hold menu prices steady. Convergence into the food category will continue to redefine competition, as convenience stores and grocers stock more prepared foods and improve their quality. Restaurants continue to source ingredients locally, both to better manage costs and offer menu options that resonates with consumers' desire (or intention, at least) to eat more healthful foods. To date, food (both grocery and restaurant) has been less vulnerable to encroachment by e-commerce, and 2012 retailer expansion plans reflect more bullish sentiment.

Among national chains, McDonald's, Chipotle, and Starbucks turned in outstanding Q4 earnings, and are slated to open the largest number of new locations this year. Colliers brokers predict that better burgers will stay hot in 2012, with Five Guys and Smashburger leading the way. Other chains such as Elevation Burger, Thunderburger, The Counter, Bobby's Burger Palace, BLT, and Shake Shack are also expanding, with made-to-order burgers or unique takes on the beloved french fry and accompanying dipping sauces. In the café space, Panera has captured significant share during the recession and recovery, and will add 115 locations in 2012; Corner Bakery is also faring well. Among sit-down restaurant chains, BJ's Brewhouse, Cheddars, Uncle Julio's, and Rosa Mexicano are among those committed to ambitious real estate programs this year.

Emerging food trends will drive expansions and innovations. Interest in Asian food has surged among mainstream operators, led by Chipotle's new concept, ShopHouse, which opened its first location in Washington, D.C., last summer. Other Asian dishes, including ramen and pho, have inspired the launch of smaller regional chains. South Indian ingredients and flavors are also making their way onto more menus. To wash everything down, bartenders continue to experiment with flavor-infused cocktails.

With more people working part-time or second jobs in the evenings, breakfast has reemerged as a hot category. Last month, Taco Bell rolled out an all-day breakfast menu at 800 locations, and McDonald's day-part data recently revealed that midnight to 5 a.m. is the fastest-growing segment of its U.S. business. Other restaurants are finally noticing what college students have been doing for years, and remaking breakfast foods to serve at dinner, a.k.a. “brinner.”

DRUG

The drugstore sector remains one of the few retail categories with three national players remaining. Recently each of the chains has reiterated its 2012 real estate program: Walgreens (150–200 new stores), CVS (250–300) and Rite-Aid (100). Collectively, these expansions represent some of retail's most aggressive store opening schedules.

The chains' 2012 expansion plans provide good news to single-tenant net lease investors, who continue to encounter low inventory levels and compressed cap rates in this property type. During 2011 Colliers tracked around 500 single-tenant drugstore transactions nationwide, observing a widening pricing gap between Walgreens/CVS and Rite-Aid. Walgreens deals averaged a 7% cap rate, with CVS about 50 basis points higher, at 7.5%. Yields on Rite-Aid deals came in significantly higher (+150 basis points) and have not compressed much in the past year.

Walgreens' long-running dispute with Express Scripts (ESRX) will continue to weigh on the chain's operation and expansion. On January 1, 2012, following unsuccessful contract renewal negotiations, Walgreens' 7,800 pharmacies left the ESRX network. The ESRX break-up spawned a feeding frenzy among Walgreens' competitors—not just CVS and Rite Aid, but big-box retailers and regional grocers—in a fight to capture its customers. Walgreens has estimated it will retain approximately 25% of the 88 million ESRX prescriptions processed in fiscal 2011, but its January sales comps (-4.6%) were much worse than analysts had forecast.

Drugstores are one of the retail categories expanding the most rapidly into e-commerce. This isn't surprising: The convenience nature of front-end merchandise—which accounts for roughly one-third of the major chains' revenues—makes them vulnerable to competition, and the shift toward a larger percentage of generic prescriptions hurts pharmacy margins. The chains' strategies, and not just the Big 3, focus most often on: 1) strategic acquisitions such as Walgreens' acquisition of drugstore.com and its just-announced asset purchase from BioScrip, Inc.; 2) rollout of apps designed to facilitate customer service (refill prescription via mobile devices, check pharmacy records and/or talk directly with a pharmacist); and 3) enhancing their social media presence via Twitter feeds and Facebook.



Many luxury brands and conglomerates reported double-digit sales growth in 2011. Executives remain bullish on growth over the next several years despite concerns about a slowdown in the enormous—and still relatively underserved—Chinese market. Consumers in Japan are slowly resuming their buying habits as the country recovers from last spring's tsunami. Lesser demand from some parts of Europe should be cancelled out by growth in Brazil and the Middle East.

Here in the U.S., the stock market rebound soothed the nerves of many well-heeled shoppers. Retailers and property owners argue that their core luxury shopper never wavered during the recession; she merely became more discreet in her buying behavior and made more thoughtful choices. Now, though, shoppers in those highest income brackets are feeling less self-conscious and emboldened that they've "survived." This bodes well for both higher quantities sold and positive responses to brand extensions and exclusives.

At a more granular level, look for leather goods, watches, and couture apparel to perform well in the coming year. Men's fashion and men's accessories have been making a comeback, perhaps inspired by "Mad Men." Last year, global menswear sales grew by 14% versus only 8% for women's, according to a Bain & Co. study. Granted, menswear has a ways to go to catch up to women's wear business, but in several rapidly growing luxury markets, such as China, men make up the majority of the customer base.



U.S. manufacturing is expected to make a significant contribution to GDP growth this year.

Full-Year Outlook:

NINE TRENDS TO WATCH

Apart from the continuing evolution of e-commerce—and its effects on how retailers leverage their real estate platform—here's what else we're envisioning for 2012:

1) Another wild ride for equities

The U.S. equities markets will continue to react to news on any and all economic indicators, however insignificant, only to adjust a day or two later either as shorts take their profits or as a buying opportunity emerges. Colliers expects increased market volatility during several periods: 1) mid-February to late March, the deadline for the Eurozone to decide on whether to extend Greece additional funding; 2) late June-early July, when the Supreme Court is expected to wrap up its debate on the constitutionality of health-care reform legislation; and 3) October-November, before and after the presidential election. Colliers projects that the U.S. equities markets will end the year flat or only marginally higher than their current level.

2) U.S. manufacturing improvement accelerates

The manufacturing sector gathered momentum in the second half of 2011: welcome timing as public sector spending cuts began to slow the pace of economic growth. Durable goods orders ended the year up 3.0% in December and were revised upward to 4.3% for November. For much of last year, companies quietly added back shifts, rehired laid-off workers, and then added new positions in many parts of the country that were hit hard. Detroit, Toledo, and Grand Rapids are among the strongest-recovering metropolitan areas. We expect this trend to continue as consumer optimism (and beat-up cars and fridges) releases pent-up demand for durables. In this extended environment of low interest rates, businesses and households are also more comfortable with—or more capable of—taking on new debt. Look for sales of big-ticket items to improve in lockstep with public perceptions about the employment picture (but not necessarily the employment rate). Separately, U.S. firms continue to benefit as intellectual-property manufacturing returns here from Asia, where intellectual property laws are less respected.

UNITED STATES | RETAILER REPORT CARD

RETAILER	MOST RECENT REPORTING PERIOD	% CHG IN Y-O-Y SALES (MOST RECENT QTR)	% CHG IN Y-O-Y SALES PREVIOUS QTR	COMMENTS	OUTLOOK
DEPARTMENT STORES					
Belk	Q3 2011	6.6	5.2	sales trending up both in-store and online; undertaking store remodels	-...+.
Dillard's	Q3 2011	5.0	6.0	generated record EPS; buying a stake in Acumen, an e-commerce start-up	-...+.
JCPenney	Q3 2011	(1.6)	1.5	execs unveiled "transformation strategy,"	-...+.
Macy's	Q3 2011	5.2	4.0	category leader in multichannel integration; online sales up 40% in fiscal '11	-...+.
Nordstrom	Q3 2011	7.9	7.3	strong semi-annual sale revenues, continues to up e-commerce investment	-...+.
Neiman Marcus	Q2 2012	9.0	8.0	strongest sales growth in women's shoes, bags, beauty, and in Texas, SE, W	-...+.
Saks Fifth Avenue	Q3 2011	5.8	15.5	fewer promotions improved margins; potential affluent shopper pullback?	-...+.
Sears (U.S.)	Q3 2011	(0.7)	(1.2)	closing 100 stores, CIT halts loans to Sears suppliers	-...+.
The Bon-Ton	Q3 2011	(5.9)	(1.5)	price hikes turned off shoppers; debt downgrades; new CEO	-...+.
DISCOUNTERS					
99 Cents Only	Q3 2012	8.5	6.7	transactions up 5.6% average ticket up 3%	-...+.
Big Lots	Q4 2011	3.4	1.7	customers approve of shift away from toys, towards electronics	-...+.
Cost Plus	Q3 2011	4.0	2.8	average ticket +2.7%, well-received furniture events, beat Holiday forecast	-...+.
Costco (U.S. with/excl fuel)	Q1 2012	10.0/6.0	10.0/6.0	club competition intensifying; lower gas prices will contribute less to growth	-...+.
Dollar General	Q3 2011	6.3	5.9	same-store growth accelerating but lower margins; opening 625 stores in '12	-...+.
Dollar Tree	Q3 2011	4.8	4.7	strong earnings and sales growth against tough year-over-year comps	-...+.
DSW	Q3 2011	5.2	12.3	raised '12 guidance, expanded real estate program to 35-40 new locations	-...+.
Family Dollar	Q1 2012	4.1	5.6	fighting pressures on gross margin; California expansion going very well	-...+.
Kohl's	Q3 2011	2.1	1.9	private label and exclusive lines driving gross margin improvements	-...+.
Ross	Q3 2011	5.0	5.0	announced 2-for-1 stock split but maintained full-year guidance	-...+.
Target	Q3 2011	4.3	3.9	rewards card helped drive higher traffic; first Canada stores opening 2013	-...+.
TJ Maxx	Q3 2012	3.0	4.0	liquid inventory position provides capacity to buy into popular Holiday goods	-...+.
Tuesday Morning	Q2 2012	(4.6)	(4.1)	3.5% drop in store traffic, 1.1% drop in average ticket	-...+.
Walmart (U.S.)	Q3 2012	1.3	(0.9)	new strategies takes aim at Amazon for online purchases and fulfillment	-...+.
SPECIALTY APPAREL					
The Buckle	Q3 2011	9.1	8.9	consistent leader in specialty comp growth	-...+.
Destination Maternity	Q1 2012	(4.1)	(1.7)	store closures, cannibalization with Macy's leased space hurt comps by 1-2%	-...+.
The Gap	Q3 2011	(5.0)	(2.0)	online one of the few Q3 highlights; Athleta now open in LA, DC, MSP, Phila.	-...+.
H&M	Q4 2011	(3.0)	2.0	hurt by European consumers' belt-tightening; aggressive expansion in China	-...+.
Hot Topic	Q4 2011	1.3	2.6	Hot Topic +2.2%, Torrid -3.2%; raised Q4 earnings guidance	-...+.
Limited Brands	Q3 2011	9.0	9.0	Victoria's Secret promotions continuing to drive double-digit comp growth	-...+.
J. Crew	Q3 2011	5.0	3.0	more full-price selling, led by ballet flats, schoolboy blazers, and mini pants	-...+.
Zumiez	Q3 2011	6.0	7.5	excellent inventory management; sales comps growth near top of sector	-...+.
HOME					
Bed Bath & Beyond	Q3 2011	5.6	7.0	results beat on strong sales, higher margins, fewer markdowns	-...+.
Home Depot (U.S.)	Q3 2011	3.8	3.5	strong sales in core, storm-related sales; lifted FY guidance, raised dividend	-...+.
Lowe's	Q3 2011	0.7	(0.3)	poor earnings weighed down by store closings, discounted product lines	-...+.
Pier 1	Q3 2012	7.0	10.8	stellar quarter; launching new e-commerce site this summer	-...+.
Williams-Sonoma	Q3 2011	7.3	6.5	West Elm, e-commerce, event-triggered marketing drove Q3 out performance	-...+.
GROCERY					
Kroger (with/excl fuel)	Q3 2011	10.3/5.0	9.3/5.3	32 consecutive quarters of supermarket same-store sales growth	-...+.
Safeway (with/excl. fuel)	Q3 2011	7.4/1.5	7.1/0.5	beat analyst estimates but strong private-label brands weighing on margins	-...+.
Supervalu	Q3 2012	(2.9)	(1.8)	EPS missed analysts' estimates, turnaround efforts to combat slowing growth	-...+.
Winn-Dixie	Q1 2012	3.3	3.2	sales increases from fuelperks! (T) reward program, remodeled stores	-...+.
Whole Foods	Q1 2012	8.7	8.7	higher revenues, higher margins raised 2012 guidance	-...+.

* Sources: Company Reports, Colliers Research

UNITED STATES | RETAILER REPORT CARD

RETAILER	MOST RECENT REPORTING PERIOD	% CHG IN Y-O-Y SALES (MOST RECENT QTR)	% CHG IN Y-O-Y SALES PREVIOUS QTR	COMMENTS	OUTLOOK
RESTAURANTS					
Applebee's	Q3 2011	(0.3)	3.1	hurt by increasing commodity costs; first quarter of negative comps in 2 years	- +
BJ's Restaurants	Q3 2011	6.5	6.9	opening 15 locations in 2012, reiterated expansion to continue in 2012/14	- +
Bob Evans	Q2 2012	(1.5)	(1.7)	same-store sales improved through the quarter; successfully holding costs flat	- +
Brinker Int'l	Q2 2012	1.7	1.9	Chili's growth slows; corporate revenues came in below expectations	- +
Buffalo Wild Wings (owned)	Q4 2011	8.9	5.7	strong Q4 earnings; continuing to test iPad ordering programs in-store	- +
Burger King (U.S./Canada)	Q2 2011	flat	(5.3)	weakest BK division worldwide; menu changes, marketing shifts continue	- +
Cheesecake Factory	Q3 2011	0.8	2.3	Q3 miss; increasing '12 openings, including first in Middle East	- +
Grand Lux Café	Q3 2011	0.9	flat	1 new location planned for 2012	- +
Chipotle	Q4 2011	11.1	11.3	higher traffic generating most of comp gains; opened 67 restaurants in Q4	- +
Darden	Q2 2011	1.8/3.9	2.8/5.1	strong growth at Longhorn, Cap. Grille; Olive Garden turnaround continues	- +
Denny's	Q3 2011	0.9	2.0	owned and franchise locations each comp-ing up, but with less momentum	- +
Domino's	Q3 2011	3.0	4.8	still reaping benefits from new crust, cheese, and sauce blends	- +
Dunkin Brands	Q4 2011	7.4	5.6	added 600+ net new Dunkin' Brands and Baskin-Robbins in 2011	- +
Einstein Noah	Q3 2011	1.0	(0.8)	focused on core breakfast/lunch daparts, adding franchisees	- +
Kona Grill, Inc.	Q4 2011	7.8	10.6	8th consecutive quarter of positive trends; 1st profitable year since '04	- +
Krispy Kreme	Q3 2012	4.0	5.8	12th consecutive comps increase; projecting 25%+ income growth for 2012	- +
McDonald's (U.S.)	Q4 2011	7.1	4.4	breakfast Dollar Menu, expanded beverages driving comps growth	- +
P.F. Chang's	Q3 2011				- +
P.F. Chang's	Q3 2011	(3.7)	(2.5)	price increases, Hurricane Irene hurt comps; opening 3-5 locations in 2012	- +
Pei Wei	Q3 2011	(3.6)	(2.7)	price increases, Hurricane Irene hurt comps; opening 16-20 locations in 2012	- +
Panera Bread	Q4 2011	5.9	6.0	projecting 7.0-7.5% comp sales growth for 2012	- +
Ruby Tuesday, Inc.	Q2 2012	(4.2)	(4.1)	up against strong year-over-year comps, but core customer feeling pinched	- +
Ruth's Hospitality	Q4 2011				- +
Ruth's Chris	Q4 2011	7.7	2.6	7th consecutive quarter of comp sales growth	- +
Mitchell's Fish Market	Q4 2011	0.4	(0.7)	new President/CEO an expert in positioning for "growth and profitability"	- +
Starbucks (U.S.)	Q1 2012	9.0	10.0	strongest holiday in 40-year history; Blonde Roast rollout began in January	- +
Yum! Brands (U.S.)	Q4 2011	1.0	(3.0)	Pizza Hut rebound pushed U.S. comps positive; Taco Bell tests breakfast menu	- +
HOBBY					
Barnes & Noble	Q2 2012	(0.6)	2.0	boosted by Borders closings, Nook revenues offset declines in book sales	- +
Best Buy	Q3 2011	0.9	(2.8)	comps up in tablets, appliances, e-Readers; gaming, digital imaging declined	- +
Cabela's	Q3 2011	(1.6)	4.4	reduced promotions to protect margins; new Edmonton store outperforming	- +
GameStop (U.S.)	Q3 2011	0.2	(9.1)	expanding program to buy/sell/trade used iDevices; first-ever cash dividend	- +
Office Depot (N. America)	Q3 2011	(2.0)	(1.0)	strong sales of supplies, weak technology sell-through; testing PayPal	- +
OfficeMax	Q3 2011	(4.3)	(0.3)	soft Back-to-School season, maintained margins at expense of revenues	- +
PetSmart	Q3 2011	6.1	5.0	comp transactions up 2.2%; strong growth in super-premium foods	- +
Staples (N. America)	Q3 2011	(1.0)	flat	waiting on results of Holiday initiatives; Office Depot/Max buyout rumors	- +
AUTO					
Advance Auto Parts	Q3 2011	2.2	2.4	record revenues, profits; commercial sales an attractive growth sector	- +
AutoZone	Q1 2012	4.6	5.3	12th consecutive quarter of 20%+ earnings growth; testing stores in Brazil	- +
O'Reilly's Auto Parts	Q4 2011	3.3	4.8	record revenues and earnings for both Q4 and 2011	- +
Pep Boys	Q3 2011	(0.4)	(2.0)	service center sales up; launched TreadSmart for online research, tire buying	- +
PHARMACY					
CVS	Q4 2011	2.5	2.3	raised full-year guidance as it expects more Rx transfers from Walgreens	- +
Rite-Aid	Q3 2012	2.0	2.2	Q3 results above expectations but weak balance sheet very worrying	- +
Walgreens	Q1 2012	2.5	4.4	filled 208 million scripts in Q1; ESRX defections higher than estimated	- +

3) More shoppers choosing “Experience” over Price

We’ve been talking about “value” since 2006, but it’s worth reiterating that value is a dynamic concept. Consulting firm Alexander Babbage defines “value” as *Experience divided by Price*. Retailers increase the value they provide by either lowering their prices (streamlining production costs, offering the same product in a smaller package) or increasing the quality of their experience (unique product, more prestige, better customer service, better multichannel integration). As this recovery continues to illustrate, most successful retailers fall into either the luxury or discount sectors, with a muddle in the middle. As discussed earlier in this report, competitive pricing alone will not ensure long-term shopper loyalty. Retailers can increase revenues and/or expand their market share if they aim to remove every potential barrier that stands between their customers and the conversion of their interest to purchase intent, and then to purchase. Innovation in any of the following areas will greatly improve the customer experience: 1) creating and maintaining an easy-to-navigate website (and one that doesn’t crash at peak traffic times); 2) ensuring adequate parking and easy-to-follow signage within a retail property; 3) providing accurate sizing guidance (to minimize back-and-forth returns); 4) prudently managing inventory levels (both in-store and online); 5) minimizing wait time in checkout lines; and 6) removing restrictions in the returns process and inconsistencies between in-store and online policies.

4) Retailers roll out more limited editions and exclusives

2011 retail sales benefitted from newness in product assortments, in particular apparel, that piqued shopper interest. Some of 2011’s most successful sell-throughs were exclusives and/or limited editions such as Missoni at Target and JLo/Marc Anthony at Kohl’s. Limited-time offers (LTOs) drive traffic and generate urgency in a shopper who must be “sold” before parting with her money, especially for a full-price item. Lower inventory levels will compound that urgency this year, for retailers committed to tighter Spring and Summer buys last summer as economic sentiment was tanking. Exclusives are also another way for retailers, especially those in the luxury sector, to differentiate themselves, deepen loyalty with existing customers, and attract new ones (recent examples include Banana Republic’s new deal with Trina Turk, and Nanette Lepore joining forces with JCPenney). And, as discussed earlier in this report, merchandise or deals available either only online or via a mobile device are expected to increase this year. Interestingly, restaurants haven’t been as successful with LTOs; they will remain focused on custom offerings during different day parts, i.e., happy-hour specials, to drive traffic and revenue.

5) More strategic acquisitions across brands, assets, property sectors, and technology platforms

In this slow-growth, market-share play environment, well-capitalized companies find it far easier to expand through acquisition. 2011 brought many examples of retailers investing in smaller companies to enhance their multichannel integration: Nordstrom/HauteLook, Walgreens/drugstore.com, and Walmart/mobile shopping app maker Small Society, to name a few. Strategic acquisitions also allow the acquirer to extend its brand outside its core competency, such as Starbucks picking up juice bar concept Evolution Fresh. Looking ahead to 2012, the pace of acquisitions will accelerate with the continued expansion of e-commerce. The scalability of existing online fulfillment programs is becoming a significant issue and a source of a large percentage of consumer complaints when purchase deliveries are delayed during high-volume transactions periods such as the

week before Christmas. Is this the year that Amazon takes an equity stake in a shipping company or buys out the U.S. Postal Service? Acquisitions and opportunistic equity infusions aren’t limited to brands and technology applications. In real estate, we’re watching owners in the grocery and strip anchor space for some opportunistic asset buys. Blackstone alone has been involved in three large transactions in the past year, and more than a dozen other institutional players are scouting around for retail portfolios. There is always the chance that a privately-held regional mall will change hands, too. Public REITs picked up several top-tier properties in 2011, and many of them are sitting on huge capital reserves.

6) The distressed asset pipeline FINALLY begins to move

Following several years of predictions that “THIS” is the year that transaction activity will pick up, the markets must begin to force the issue in 2012. Data from Trepp and the Federal Reserve show that more than \$350 billion in commercial real estate loans will mature in both this year and 2013. A large percentage of that liability are 5-year loans from the 2007 vintage that were underwritten with (or now have) high loan-to-value ratios, limited amortization, or are tied to marginal assets in illiquid markets. The CMBS sector faces a risky year too: Standard & Poor’s estimates that \$55 billion worth of CMBS is scheduled to mature, versus the estimated \$35.0 billion of non-agency CMBS issuance projected. The opportunity for retail investment lies between the trophy assets, that will continue to trade at low cap rates, and the large pool of marginal, low- or no-cash flow assets that won’t be able to refinance, and will either default on maturing debt or be transacted in a “fire sale.” In this middle range, though, it is possible to find assets whose pricing has dropped to levels approaching replacement cost. The properties most likely to move are those with upside potential in cash flows, combined with interest from a well-capitalized investor able to amortize up-front due diligence costs over an extended period until the property can be turned around.

7) Foreign investors ♥ the U.S

Yield-seeking investors need places to park their money, and the stability of U.S. property markets still make them attractive destinations for “flight capital.” Recent data from the Association of Foreign Investors in Real Estate (AFIRE) confirm that the U.S. is still a leading destination for global capital flows: New York and Washington, D.C., rank first and third (London was #2). The pace of investment could accelerate if the U.S. changes its regulatory policies to better streamline and accelerate regulatory approvals for foreign investment. Among property types, though, foreign capital has favored core assets in coastal markets. With pricing for those deals getting too rich, and concerns that the pace of rent growth can’t be sustained, foreign entities (and their U.S. representation) may now look to shopping centers or broken land deals in space-constrained or high-growth markets. We also expect more risk-taking as cap rate compression and low inventory levels of core product force both institutions and individuals to broaden their exposure. One caveat to foreign investors’, especially Europeans’, interest in U.S. assets: Given their troubles at home, they will closely scrutinize the financial health of the municipalities where the assets (or any loans on those assets) are located.

8) Expanded capacity, stringent underwriting in the debt markets

Non-performing real estate loans remain highly problematic for all banks, but stronger regional banks have slowly resuming commercial lending. In the past year, these banks began to work through their portfolios of bad loans and

have freed up capital to invest in other projects, including loan origination. *National Real Estate Investor's* recent "Borrower Trends" survey found that 56% of lenders and 44% of borrowers are predicting more credit availability in 2012. NREI also predicted that loan volumes will grow an additional 12.2%, on top of a 10.8% rise in 2011. As mortgage production ramps up, investors will see banks being more competitive but with far more stringent underwriting standards. Properties need to demonstrate solid cash flow and real net operating income (NOI), and assume conservative rent increases; any loans approved will be recourse except for the best customers. Lending standards will keep origination growth at modest levels, but the expanded debt capacity couldn't be better for investors who financed at the peak of the market five years ago. The limited supply of debt means that capital will still chase lower-risk assets, though, as the volume of bank loan and CMBS maturing debt will remain high for the next 4–5 years.

9) Urban site-seeking retailers, including big boxes, are back in force

The housing crisis hit suburban and exurban communities much harder than their urban counterparts. When retailers seek out lower-risk growth opportunities today, underserved urban areas fall firmly within the crosshairs. Blocked out of urban areas in the past because their stores were too large, big-box retailers now have two options: 1) They can go in with their large-format stores, as their renewed interest in urban locations coincides with municipalities' worsening fiscal problems; in the past, local groups may have succeeded in blocking these openings, many municipalities now desperately need the sales tax revenue and can't risk their bond ratings—or their executives' political capital—turning big-box retailers away. 2) Retailers can test small-format store options, take infill space, and steal share from smaller local operators through wider assortments and lower prices. Besides big-box retailers, pure-play grocers are also finessing their smaller-store formats, and their necessity-based product mix makes officials and investors much more comfortable approving new developments. Building new retail still won't be easy: Municipal staffing cuts are taking effect just as more personnel are needed to issue permits and certificates of occupancy, review proposed zoning changes, and solicit or manage any public-private partnerships.

A PIVOTAL YEAR FOR THE INDUSTRY

Based on economic indicators and sentiment, 2012 has begun much like 2011 did. We can almost guarantee that it won't end this way, judging just from known future events: the decision on health care constitutionality; the run-up to, and outcome of, the Presidential election; and the ongoing march toward debt maturities both here and overseas. There are so many moving parts that it's hard to get this report out the door without feeling as though it'll be out-of-date tomorrow, let alone later this year.

From retail's perspective, though, there are reasons to be optimistic—understanding that the economy still has a long way to go, and even when fully recovered, we'll never get back to 2007. For the ~85% of U.S. households not dealing directly with unemployment (or underemployment), the deleveraging process has progressed to a point where they could be contributing more strongly to retail sales growth as early as mid-2013. The growth in the manufacturing sector has huge spillover effects for the national economy, which will only strengthen as low interest rates allow companies to make long-term capital investments. Finally, continued U.S. population growth in high-potential demographic segments creates a shopper base that will stimulate demand for retail product.

We can't emphasize enough that 2012 is a huge year for retail, and real estate in general. Landlords' and retailers' response to mobile commerce, and their ability to partner and innovate, will determine how well they can monetize shoppers who are already in their physical space—a huge advantage over earlier e-commerce, which was all transacted somewhere else. Even if economic indicators remain inconclusive for the next few quarters, the retail space is poised to generate a lot of headlines as the competition to win shoppers' hearts and wallets grows ever more fierce.

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Canada: 38
Latin America: 18
Asia Pacific: 214
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- Over 12,500 professionals and staff
- 350 Retail professionals in 63 U.S. Offices

COLLIERS INTERNATIONAL

601 Union Street, Suite 4800
Seattle, WA 98101
TEL +1 206 695 4200

FOR MORE INFORMATION

Ann T. Natunewicz
Manager, Retail Research | USA
TEL +1 202 742 1105
EMAIL Ann.Natunewicz@colliers.com

K.C. Conway, EMD, Market Analytics,
contributed data and insights to this
report.

Designer: Davin Schnappauf

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