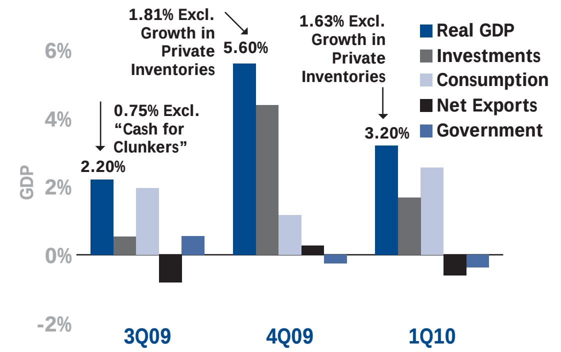
Marcus & Millichap
RESEARCH SERVICES
THE OUTLOOK

Economic Recovery Gaining Traction; Increased Business Activity Needed for Expansion to Become Self-Sustaining

The economic recovery continues to make headway, with GDP posting its third consecutive increase during the first quarter. Although the headline rate of growth reflects a deceleration from late 2009, underlying shifts among the contributing components provide cause for optimism. To start, business spending continued to rise, with investments in equipment and software registering a third consecutive increase for the first time since before the recession began, suggesting the transition from a stimulus-driven recovery to a sustainable business expansion cycle is already under way. Another positive sign came from personal consumption, which made its greatest contribution to quarterly GDP growth since early 2007. The first quarter bounce in consumer spending reflects pent-up demand and the impact of some temporary factors. Spending growth will moderate in the near term, but the strong upward trend signals another step in the right direction. Additional bright spots in the economy include negligible inflation and a largely accommodative Fed, which remains focused on facilitating a self-perpetuating recovery.

Contributing Components to Real GDP



Sources: Marcus & Millichap Research Services, BEA

Headwinds Subside. The fall 2008 freezing of the commercial paper market and transition from credit crunch to a full-blown financial crisis had immediate and long-lasting repercussions for businesses and the broader economy that have only recently begun to fade. In the last several months, sectors that dragged heavily on the economy through the recession stabilized or started contributing to growth.

- **Inventory Liquidation Cycle Ends.** Companies began to slowly restock shelves in the first quarter and will need to build inventories further this year as demand improves, which will bode well for the economy. The combination of reduced end-user demand and companies' inability to secure short-term credit set off a drastic inventory correction cycle that persisted through most of 2009.

- **Renewed Business Spending.** Healthy corporate profits in recent quarters and forecasts for moderate levels of revenue growth during 2010 support expectations for strengthening business spending and hiring as the year progresses. Following nearly two years of drastic cost-cutting and capital conservation, companies are sitting on record levels of cash, more of which will be put to use as more businesses resume expansion this year.

- **Home Sales Moving off Floor.** Foreclosures and short sales will threaten home prices for much of 2010, but deep discounts and opportunistic buying should support strengthening sales, even after the recent expiration of the homebuyer tax credit. Housing was one of the first economic dominoes to fall and will be among the last to recover; however, home sales have increased from their early-2009 low.

Indicators Reflect Worst in Past, Recovery Under Way. GDP returned to positive territory in the third quarter of last year and surged in the final months, while retail sales recently surprised to the upside. Though the latter was partially attributable to an early Easter holiday, consumers' willingness to spend more, especially in the absence of significant job creation, suggests growing confidence in the budding recovery. Overall, households will continue to deleverage, limiting future expectations

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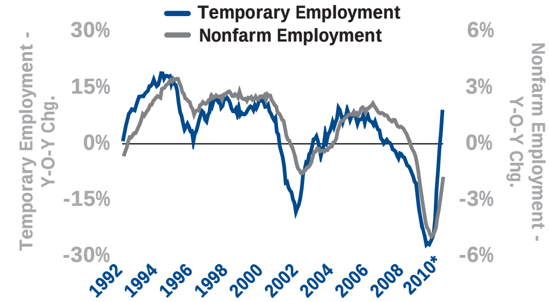
for retail sales growth. While housing-related losses to households' net worth will take years to be recaptured, strong stock market performance in recent quarters helped improve balance sheets and restore retirement accounts. Barring the onset of another bear market cycle, the "wealth effect" will become more pronounced, particularly among higher-income households, which account for the greatest share of spending nationwide.



Temporary Job Trend Reflects Positive Momentum Building

* Through March
Sources: Marcus & Millichap Research Services, BLS

Employment Growth Resumes. After inclement weather doused hopes for a February turnaround, U.S. employment grew by 162,000 jobs in March, the greatest gain in three years. With the exception of financial activities and information employment, which shed a combined 33,000 jobs in March, all major sectors posted growth. More than half of the positions added were short term, as the federal government hired 48,000 census workers, and temporary help services grew for the sixth consecutive month. The addition of 313,000 temporary positions since last September indicates increased demand for workers but a prevailing sense of caution among employers. As more concrete signs of sustainable growth emerge in the near term, hiring of permanent workers will resume slowly.

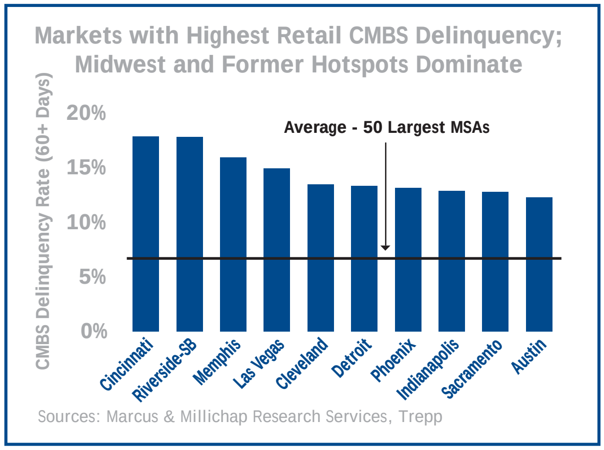
Forecast:

Temporary Economic Support Priming the Pump. GDP growth, even if based on temporary factors, will translate into easing uncertainty and improved consumer confidence, kindling a sustainable and strengthening expansion cycle by late this year. Government stimulus propped up consumer spending and overall GDP during the past few quarters, and the hiring of 1.1 million census workers this spring will provide another temporary boost, helping reignite real growth drivers. Census jobs will disappear by summer, but the rise in income should encourage more near-term spending and demand, which is necessary to push-start the jobs engine and ultimately transition from recovery to self-perpetuating expansion.

This Year to Set Stage for More Robust Growth in 2011. GDP growth in 2010 will align closely with long-term trends, averaging 2.5 percent to 3.0 percent. Job creation is expected to advance at a below-trend rate near 0.75 percent, or just under 1 million positions, as employers shift into expansion mode cautiously. The depth of payroll cuts during the recession, totaling more than 8.4 million positions, could lead to better-than-expected hiring in some of the hardest-hit industries by the second half of this year and support more significant job growth of 2.2 percent and 2.7 percent in 2011 and 2012, respectively.

Commercial Real Estate Investment Improving, but Conditions Fragile. Many investors have returned to the marketplace after a prolonged hiatus, increasing competition for the limited number of well-located, healthy assets that have become available. Private investors will continue to account for most of the transactions this year, but REITs will step up activity after raising a tremendous volume of capital in 2009. Most investors have accepted that a flood of high-quality distressed assets will remain elusive and have become cognizant that trying to time the precise bottom of the market could lead to missed opportunities. Bank-owned listings are rising, but the majority of REO activity remains concentrated among lower-quality and poor-performing properties. While more sidelined capital will return to the commercial real estate market in 2010, transaction velocity will be capped by another year of tight lending as commercial real estate losses contribute to more bank closures and an overall sense of risk-aversion prevails.

Quality Driving Property Pricing and Marketability; Retail Sales Upside Surprise Welcome News



Following a late-2009 surge in retail property sales volume, led by a handful of large deals involving REITs eager to raise capital, activity in early 2010 appears to have retreated to levels more in line with recent trends. Aside from tight credit markets and a still-present, albeit narrowing, gap in buyer/seller expectations, a persistent shortage of high-quality retail listings continues to hamper transaction velocity. This trend will continue in the near term but should begin to ease as 2010 progresses and more owners start to prune and reposition portfolios ahead of the next retail recovery cycle. Today's marketplace offers investors the unique opportunity to secure solid long-term investments at some of the most attractive pricing and cap rates this decade.

Stronger Returns Lure Buyers. Cap rates have increased across the board, though to varying degrees, with the average in primary metro areas 100 basis points higher than two years ago and secondary markets up closer to 150 basis points. Private investors continue to dominate acquisitions, particularly those involving distressed assets, but institutions and capital-flush REITs stepped up retail acquisition activity during the second half of 2009.

Encouraging Signs Emerging for Retail Sector. Retail sales surged 1.6 percent in March, after posting 0.5 percent gains during each of the previous two months. While an early Easter holiday may have contributed to the strong showing, increases were widespread across retail sectors and led by auto sales, which advanced 6.7 percent during the month. Stronger retailers already are going on the offensive, picking up desirable space in preferred locations at dramatically reduced rents. This trend has been pronounced in the big-box sector, which experienced a run-up in vacancy during the recession due to major bankruptcies by national tenants such as Mervyns, Circuit City and Linens 'n Things. Expanding chains, including Best Buy, Kohl's, Dollar Tree, and other discount or necessity-based retailers, have targeted vacant big boxes in historically tight and densely populated metro areas, particularly along the coasts. Lesser-quality locations have not experienced this rise in demand.

Overbuilt Housing Markets Hard-Hit. Fundamentals have softened in every major market over the last year amid reduced tenant demand and continued retailer consolidation, but several metros also face lingering oversupply issues. Hard-hit housing markets such as Phoenix, Las Vegas and Riverside-San Bernardino continue to encounter challenges leasing retail space constructed in far-reaching suburbs to serve subdivisions that failed to come to fruition. These markets have advanced to the upper end of the vacancy spectrum and CMBS retail delinquency list, joining typically higher-vacancy Midwestern markets, such as Detroit, Cincinnati and Cleveland.

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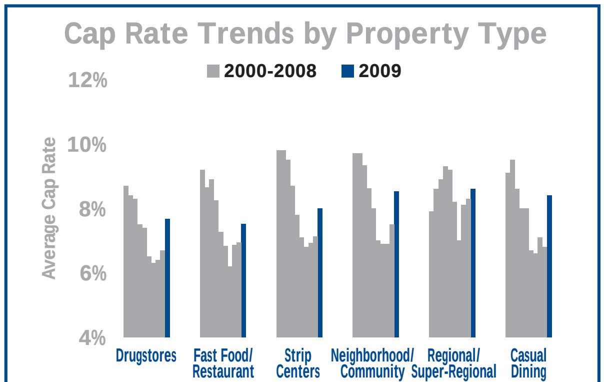
Forecast:

Developers Retreat; Record-Low Construction Anticipated. Elevated vacancy and a near shutdown in construction lending will mute new supply-side pressures in 2010 and 2011. After cutting completions by more than 50 percent in 2009 to 98 million square feet, developers will deliver just 70 million square feet in 2010, the lowest level on record. The planning pipeline has thinned 20 percent since first quarter of 2009, on top of a 20 percent reduction over the previous year, suggesting the slowdown will carry through until at least 2011.



Includes sales $500,000+
Sources: Marcus & Millichap Research Services, CoStar Group, Inc.

Vacancy Increases, Rent Reductions Slowing. Another year of soft tenant demand will outweigh the benefits of reduced construction in 2010. Vacancy will rise 50 basis points to 10.4 percent as a result, following a 160 basis point increase in 2009. With retailer requests for rent reductions expected to ease and vacancy forecast to rise at a slower pace, asking and effective rents will decline 2.0 percent and 4.2 percent, respectively, compared with decreases of 4.8 percent and 7.1 percent last year. Rents at newer properties, where rates exceed the market average by 30 percent to 40 percent, will register the most significant cuts.

Buyers Returning to Market, but Tight Credit Persists. Retail property sales began to increase in the second half of 2009 and should accelerate further this year. The buyer/seller expectations gap is narrowing, banks have begun to reclaim and dispose of more distressed retail assets, and more investors are actively pursuing attractive acquisition opportunities. At the same time, extremely tight financing conditions will persist, despite renewed activity in the CMBS sector, as risks associated with retail continue to deter lenders.

Focus on Quality Intensifies. Investors' and lenders' flight to safety and preference for quality will continue to dominate sentiment this year, generating multiple offers on premium properties.

- Cap rates and prices will diverge further based on quality and location, with top-tier assets in primary markets registering the least correction. The buyer pool will remain limited for lower-quality properties and assets in secondary/tertiary markets, due in large part to a lack of available financing. Cap rates for the best multi-tenant properties begin in the mid-7 percent range, nearly 100 basis points lower than the national average, while properties with above-average vacancy rates or near-term lease rollovers may have to be underwritten with cap rates approaching 10 percent to entice buyers.

- Demand for single-tenant retail assets occupied by credit tenants and secured by long-term leases will escalate more rapidly this year than for other property sectors. In addition to a growing focus on quality, a recent rise in commercial real estate sales, particularly apartments, bodes well for the single-tenant sector, as many long-time owners of management-intensive, commercial properties will trade into this segment.

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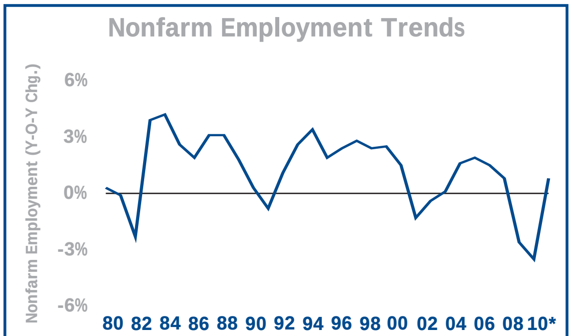
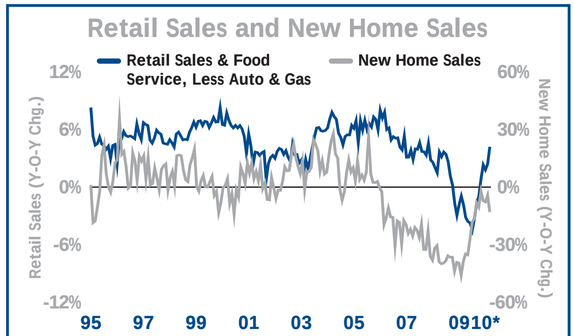
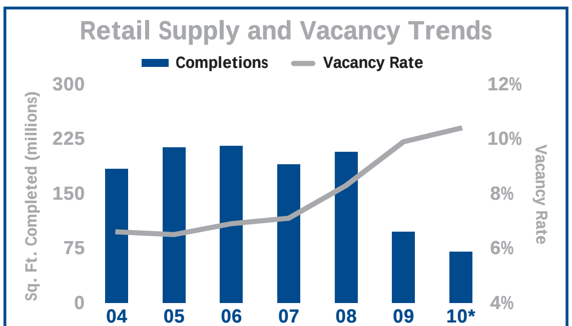
Retail Market Vital Signs



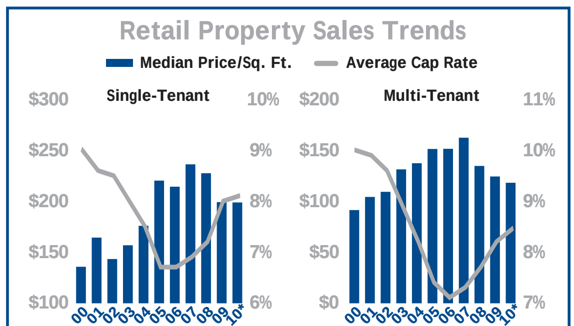
* Forecast
Sources: Marcus & Millichap Research Services, Economy.com



* Through March
Sources: Marcus & Millichap Research Services, Economy.com



* Forecast
Includes single-tenant and multi-tenant
Sources: Marcus & Millichap Research Services, CoStar Group, Inc.



* 1Q Estimate
Sales figures represent transactions of $1 million+
Sources: Marcus & Millichap Research Services, CoStar Group, Inc.

1Q 2009 to 1Q 2010 Change in Retail Vacancy

Top 10 Markets by Least Change in Vacancy

Metro	1Q 2010	Y-O-Y Chg. (bps)
Houston	12.3%	-60
San Antonio	9.2%	-30
Denver	10.1%	-20
San Francisco	4.3%	10
St. Louis	10.2%	20
Cincinnati	13.6%	30
Baltimore	7.5%	30
Charlotte	9.1%	40
Minneapolis	9.6%	50
Kansas City	11.0%	50
U.S. Metro Total	**10.0%**	**110**

Top 10 Markets by Greatest Change in Vacancy

Metro	1Q 2010	Y-O-Y Chg. (bps)
Fort Lauderdale	11.7%	230
Louisville	12.4%	230
West Palm Beach	10.9%	220
Jacksonville	11.0%	200
Sacramento	11.2%	200
Phoenix	12.3%	200
Orlando	10.9%	190
Riverside-San Bernardino	11.9%	190
Tampa	10.1%	180
Oakland	7.7%	170
U.S. Metro Total	**10.0%**	**110**

Sources: Marcus & Millichap Research Services, Reis

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