MARKET UPDATE

June 2011

Focus: Sacramento Retail Market

Sustained Contraction

Market conditions within the retail sector continue to contract, albeit at a slower pace compared to previous years. Demand for retail goods and services has been hurt by high unemployment rates and low consumer confidence. These factors, coupled with stringent lending requirements, have served to maintain the downward trend within the retail sector.

Market participants indicate that rental rates within the Sacramento region remain at 10-year low levels and the overall volume of property sales remains relatively limited. However, it should be noted, the overall rate of decline has eased in recent months and additional significant drops in rental rates or property values are not expected over the next 12 months.

Although an acceleration of the current contraction is not projected, there are several outside factors that may contribute to sustaining depressed market conditions within the retail market. Specifically, the adoption of a new state budget has the potential to significantly affect the regional economy, as additional job loss and/or higher tax rates may be implemented in an effort to balance the budget. California already ranks as one of the least business friendly states in the US and any further tax encumbrances or regulations may be too much for already reeling businesses to handle.

Additionally, consumer confidence remains extremely low, which is highlighted by the fact The Conference Board's Consumer Confidence Index fell from 66.0 in April 2011 to 60.8 in May 2011.

Notable recent sales transaction at 5400 Date Avenue in Sacramento – older big box retail @ $22.88 psf.
Source: CoStar

Continued fears regarding gas prices, employment levels and the housing market serve to erode consumers' faith in current economic conditions. Increased commodity prices have also reduced discretionary income for many households and, as a result, overall spending levels are also down.

Despite the uncertainty and pessimistic outlook for the retail market, there are some positive signs that suggest certain segments of the sector are doing well. Namely, anchored retail centers, big box spaces and single credit tenant buildings (drug stores and fast food) have seen recent upticks in activity. The historically low rates have allowed some businesses to either strengthen their local presence or enter the market for the first time. Recent openings or expansions for larger tenants within the Sacramento region include Sprouts Farmers Market in Roseville and Citrus Heights, Sunflower Farmers Market in Roseville, Grocery Outlet in Davis, Sports Authority in Citrus Heights, Burlington Coat Factory and Henry's Farmers Market in Elk Grove and Blue Oaks Cinema in Rocklin.

Rental Rates and Concessions

Rental rates have remained near 10-year lows within the Sacramento region, but most market participants have indicated the overall pace of decline has eased in recent periods. This is supported by lease transactions compiled from our internal Seevers Jordan Ziegenmeyer (SJZ) database. Specifically, the following table highlights the dramatic decreases in rental rates since 2008 for retail spaces both less than and greater than 10,000 square feet. For your reference, all of the comparables are located within the Sacramento region and have been adjusted to a NNN basis.

	< 10,000 SF		> 10,000 SF	
Year	Avg. Rental Rate	% Change	Avg. Rental Rate	% Change
2008	$2.17	-	$1.58	-
2009	$1.82	-16.13%	$1.51	-4.43%
2010	$1.59	-12.64%	$0.94	-37.75%
2011 (ytd)	$1.58	-0.63%	Insufficient data	N/A

As displayed in the table above, rental rates for spaces less than 10,000 square feet declined approximately 27% overall from 2008 through 2010 and spaces greater than 10,000 square feet declined approximately 41% overall over the same period. The overall declines are largely driven by the fact landlords have been willing to settle for less rent in order to achieve any kind of occupancy and cash flow. Several surveyed landlords indicated they would rather offer low starting lease rates and make up the rent difference with steep rent escalations later in the lease terms.

Area brokers indicate additional drops in rental rates may occur during the balance of 2011; however, these declines are not expected to be dramatic. This is supported by the fact the average rental rate for spaces less than 10,000 square feet for 2011 (year to date) is only slightly below the 2010 average.

NOTABLE RECENT LEASE TRANSACTIONS - SACRAMENTO REGION

Tenant	Lease Commenced	Rentable Area (SF)	Rent/ SF/Month	Lease Terms
Goodwill	Mar-11	40,450	$0.60	NNN
Walgreens	Feb-11	14,490	$3.00	NNN
The Vitamin Shoppe	Jan-11	4,367	$2.33	NNN
Five Guys Burger & Fries	Jul-10	2,600	$2.40	NNN

It should be noted, though, that effective rental rates in the market area are being further eroded by the high prevalence of landlord concessions associated with new transactions. One area broker reported, “Almost all prospective tenants are looking for the lowest deals possible and, as a result, not many transactions are being completed. Most deals in the current market environment depend on the willingness of the landlords to give in to tenant demands.” Typical concessions include free rent periods, reduced rent periods and tenant improvement allowances.

According to market participants, free rent periods generally consist of one month of free rent per year of lease signed. However, we have seen some deals with as much as 12 months free or reduced rent with a 5-year lease. Reduced rent periods are also becoming more common and typically reflect low starting rental rates with significant subsequent rent escalations. As a consequence, significant tenant improvement allowances are becoming increasingly rare as landlords are hesitant to outlay capital in the current market environment.

Sales Activity

The overall number of sales transactions for retail properties remains relatively low throughout the Sacramento region. Downward pressure on pricing is being sustained by the increasing number of bank-owned and short sale properties that are becoming available and also investors seeking to purchase at the lowest levels possible. These problems are further compounded by the fact stringent lending requirements from financial institutions have narrowed the pool of prospective purchasers in recent periods.

Supporting this assertion, a local broker specializing in investment properties reported that, "Cash buyers are still dominating most sales transactions and lending restrictions are still so strict that they are causing many deals to fail." In fact, this broker indicated he is advising some of his clients to accept all-cash offers even if they are lower than other offers involving a lender because of the high degree of failure of buyers to obtain financing.

Even with overall sales activity being somewhat limited over recent periods, there still have been several notable transactions over the past year. Several recent sales of properties greater than 50,000 square feet are summarized in the following table.

NOTABLE RECENT SALE TRANSACTIONS

Property	Location	Sale Date	Rentable Area (SF)	Price Per SF
Target	Sacramento	Mar-11	107,365	$48.06
Former Sam's Club	Natomas	Feb-11	134,700	$55.68
PetSmart, Ulta etc.	Folsom	Dec-10	119,000	$302.52
Bel-Air	Elk Grove	Oct-10	62,963	$175.98
Badger John's etc.	Sacramento	Aug-10	135,000	$22.88

Although the above transactions reflect larger sized properties, market participants have reported that most of the sales over recent periods have been relatively smaller sized transactions.

On a positive note, single-tenant buildings occupied by credit tenants are performing relatively strongly in the current market environment. Specifically, these properties are exhibiting some of the highest sale prices per square foot and lowest overall capitalization rates for retail properties in the region. This segment of the market primarily consists of drug stores, fast food restaurants and anchor spaces. The following table summarizes average capitalization rates and sales prices per square foot for single-tenant retail properties (primarily drug stores and fast food restaurants) since 2008. This information is based on our internal database and only considers properties that had directly confirmed capitalization rates.

Property Type	Year	Avg. Cap Rate	Avg. Price Per SF
Single-Tenant Buildings	2008	6.85%	$537.93
(Credit Tenants)	2009	7.46%	$382.04
	2010	7.51%	$351.33
	2011	7.14%	$410.86

It should be noted that, although there has been contraction for these properties over the past several years, early indicators from 2011 suggest there may be some stabilization and recovery for this segment of the market in the near term. The strength of this property type is attributable to the fact investors have primarily been seeking national or credit tenants in an effort to mitigate their overall risk.

Forecast and Conclusion

A survey of market participants revealed that most expect rental rates and sales prices to see some additional declines through the end of 2011. However, the rate of decline is expected to be relatively moderate, especially compared to the significant decreases seen between 2008 and 2009. Within the retail sector, anchored and larger-scale projects are expected to fare much better than smaller projects (i.e. unanchored strip centers) going forward. New construction remains largely infeasible in the current market and with the exception of some build-to-suit projects, there is not expected to be significant construction activity over the next 12 months.

The retail sector faces uncertainty over the coming months as on-going concerns regarding the overall economy, unemployment levels and the rising costs of living continue to weigh heavily on consumers. Tough lending requirements are also limiting the amount of overall market activity, which has further prevented extensive stabilization or recovery within the region. Although additional declines may occur during 2011, some market participants expect at least some stabilization in 2012. However, unless some of the broader macroeconomic concerns like unemployment and commodity prices begin to subside, a widespread recovery is not expected in the near term.

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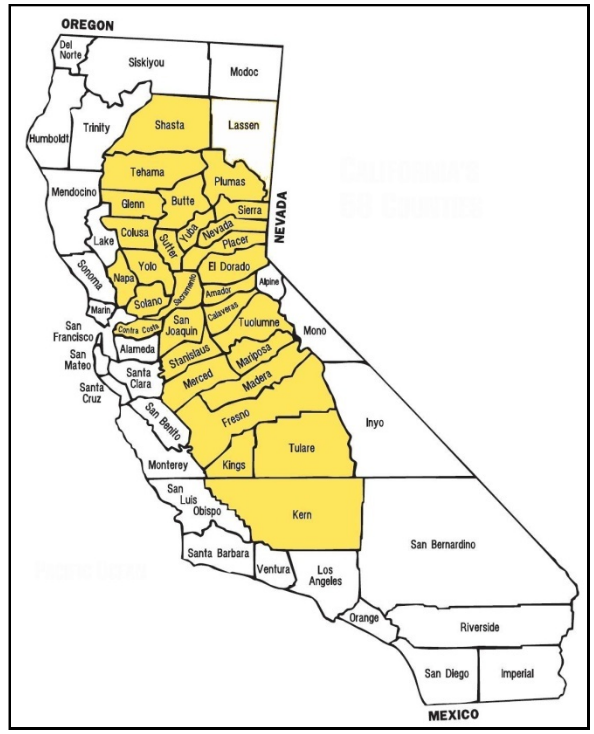
About Seevers Jordan Ziegenmeyer

Seevers Jordan Ziegenmeyer (SJZ is a commercial real estate appraisal and consulting firm located in Rocklin (Sacramento metropolitan area). SJZ services California markets from Redding to Bakersfield. Service areas include:

- General commercial (retail, office, industrial)
- Mixed-use and special-purpose
- Land and subdivisions
- Master-planned communities
- Portfolios
- Community Facilities Districts (CFDs) and Assessment Districts (ADs)
- Right of Way
- Partial Acquisition



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