RetailResearch
MARKET UPDATE
Marcus & Millichap
Philadelphia Metro Area *Third Quarter 2008*

Local Retail Buyers Focusing on Sound Underwriting

Steady construction activity and weaker consumer spending are causing Philadelphia's retail market to moderate, with department stores and casual dining restaurants struggling the most. While the local housing market has not been nearly as hard-hit as many neighboring metros, employers are cutting jobs, and retail spending is slowing. As such, several regional and national chains are scaling back operations. Boscov's, for example, recently filed for bankruptcy, closing 10 department stores, including its Oxford Valley Mall and Montgomery Mall locations. Texas-based Metromedia Restaurant Group, which owns casual dining chains Bennigan's and Steak and Ale, filed for bankruptcy in July, shuttering some restaurants throughout the metro. Deep-discount retailers and fast-food chains remain strong, however, and some higher-end retailers, such as L.L. Bean, continue to expand. As such, submarkets such as Chester County, where demographics are still strong and residents are more likely to weather the current economic downturn, will remain popular with these retail operators.

This year, investment activity within the Philadelphia retail market is expected to consist primarily of smaller buyers focusing on mid-tiered assets. Due to more conservative lending practices, capital remains limited for institutional-sized transactions, while both financing opportunities and buyers for deals under $5 million are still abundant. Private investors are using fundamentally sound underwriting to target assets where value is created by revenue growth, rather than potential capital appreciation. Currently, Class A multi-tenant properties are changing hands at cap rates in the high-6 percent to low-7 percent range, while initial yields in Class B properties are in the mid-7 percent to low-8 percent range. Looking forward, more stringent underwriting will likely increase the marketing times for many properties, as well as apply further upward pressure on cap rates.

2008 Annual Retail Forecast

0.3% decrease in total employment

Employment: After 16,800 jobs were created in 2007, cuts are expected to total 8,000 workers this year, a loss of 0.3 percent. Continued growth in the professional and business services and educational and health services sectors will help to offset reductions in other industries, however.

1.9 million square feet will be completed

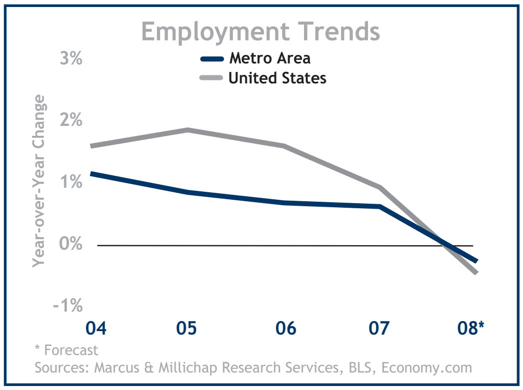
Construction: Developers are forecast to bring 1.9 million square feet of retail stock online in 2008, compared with 1.8 million square feet last year.

70 basis point increase in vacancy

Vacancy: Additions to stock this year will exceed tenant demand growth. As a result, vacancy is forecast to push up 70 basis points by year end to 7.4 percent. In 2007, vacancy declined 70 basis points.

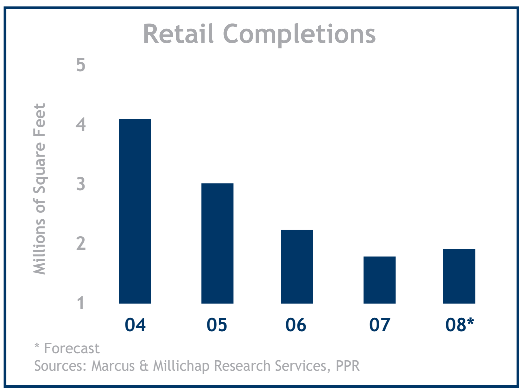
1.8% increase in asking rents

Rents: Rent growth will continue to slow over the remainder of the year. Asking rents are expected to rise 1.8 percent in 2008 to $20.30 per square foot, while effective rents tick up 0.6 percent to $18.26 per square foot. Last year, asking and effective rents increased 2.9 percent and 3.1 percent, respectively.



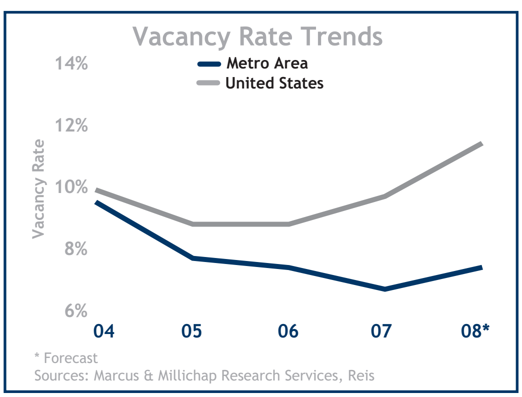
Economy

- Approximately 7,300 employees were added to Philadelphia's payrolls year over year as of the second quarter, a 0.3 percent increase. The trend has reversed in recent months, however, as nearly 5,000 positions were eliminated in the second quarter.
- Employers in the educational and health services sector have created 9,700 positions during the past 12 months. Growth within this segment is expected to persist at its current rate through the end of the year.
- The Northfield Business Campus outside of Quakertown was purchased by an affiliate of Gorski Engineering Inc. The company bought the 118-acre site with plans to develop 250,000 square feet of new office space. The move is expected to create 600 direct jobs and attract additional companies over the next 18 months, which could spur some demand for retail in the area.
- **Outlook:** After 16,800 jobs were generated in 2007, cuts are expected to total 8,000 workers this year, a loss of 0.3 percent. Continued growth in the professional and business services and educational and health services sectors will help to offset reductions in other industries, however.



Construction

- Retail inventory increased 1.1 percent year over year through the second quarter with the delivery of 2.1 million square feet. In the preceding 12-month span, 2.3 million square feet was added to the Philadelphia metro.
- A transit-oriented development district is being considered at a former industrial site near the Warminster train station. J.G. Petrucci Company Inc. hopes to convert a 16-acre parcel adjacent to the Jacksonville Plaza shopping center into a 200-home, mixed-use community, a move the would likely generate new interest in area retailers.
- In addition to projects slated for completion this year, approximately 4.6 million square feet is under construction and scheduled for delivery in 2009.
- **Outlook:** Developers are forecast to bring 1.9 million square feet of retail stock online in 2008, compared with 1.8 million square feet last year. Over the past five years, annual completions have averaged 2.6 million square feet.



Vacancy

- Vacancy has risen just 30 basis points year over year due to a modest amount of new inventory. Since the end of 2007, the metro's average vacancy rate has increased 20 basis points to 6.9 percent.
- Vacancy within neighborhood/community centers declined 20 basis points over the past year to 6.3 percent in the second quarter.
- Within the Montgomery County submarket, neighborhood/community center vacancy remains especially tight, falling 220 basis points year over year to 4.4 percent, the lowest rate in the Philadelphia metro.
- **Outlook:** Additions to stock this year will exceed tenant demand growth. As a result, vacancy is forecast to push up 70 basis points by year end to 7.4 percent. In 2007, vacancy declined 70 basis points.

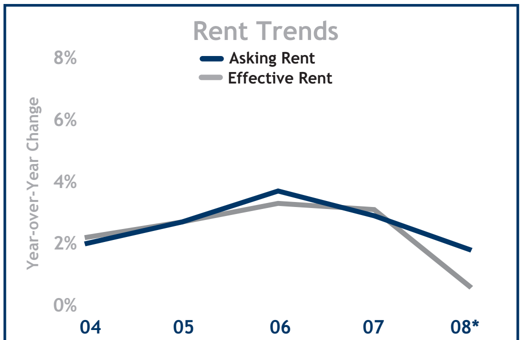
Rents

- As of the second quarter, asking rents were $20.13 per square foot, up 2.4 percent over the past 12 months. In response to an uptick in vacancy, effective rents advanced 1.6 percent during that span to $18.21 per square foot.

- Concessions have increased due to cooler economic conditions and rising vacancy. In the second quarter, concessions were equal to 9.5 percent of asking rents, compared with 8.8 percent of asking rents one year earlier.

- Revenues pushed up 1.2 percent during the 12 months ending in the second quarter, following a 4.4 percent gain in the previous year, when occupancy levels were higher and there were fewer projects in the development pipeline.

- **Outlook:** Asking rents are expected to rise 1.8 percent to $20.30 per square foot this year, while effective rents tick up 0.6 percent to $18.26 per square foot. In 2007, asking and effective rents increased a respective 2.9 percent and 3.1 percent.



* Forecast
Sources: Marcus & Millichap Research Services, Reis

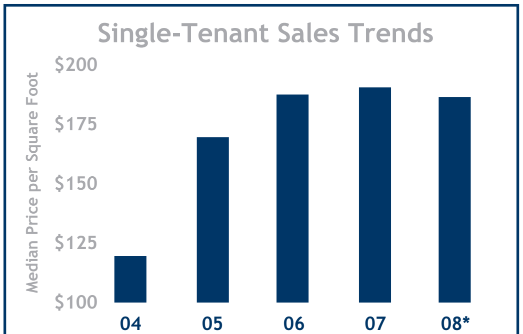
Single-Tenant Sales Trends**

- During the past 12 months, transaction velocity has fallen 2.3 percent. While most property types have recorded a slight decline in sales volume, activity within fast-food properties has risen 63 percent in that time.

- Over the last year, the median price for a single-tenant property in the Philadelphia metro has declined 8.4 percent to $186 per square foot. Some of the drop can be attributed to the more conservative lending environment and stricter underwriting criteria.

- Cap rates have averaged in the mid- to high-7 percent range during the last 12 months, nearly unchanged from the preceding year.

- **Outlook:** Cooling economic conditions are expected to keep buyers cautious over the Philadelphia single-tenant market. As a result, transaction velocity will likely slow through the second half, with sales dominated by fast-food restaurants and drugstores with national-credit tenants.



* Trailing 12-Month Period
Sources: Marcus & Millichap Research Services, CoStar Group, Inc., RCA

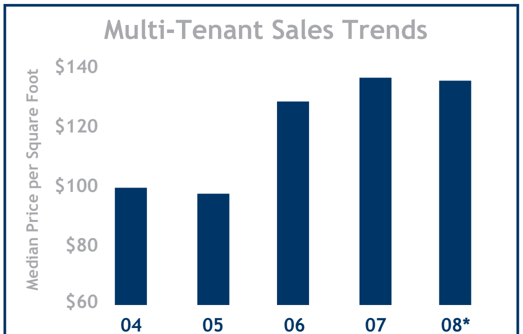
Multi-Tenant Sales Trends**

- Transaction velocity has decelerated considerably in the metro's multi-tenant sector, dropping 56 percent during the most recent 12-month period. The largest reduction occurred in lower-tier properties with local tenant bases.

- The median price for a multi-tenant retail property in Philadelphia has decreased 5 percent year over year to $135 per square foot. The decrease has been due to forecasts for decelerated rent growth going forward.

- Cap rates have remained fairly steady in the mid- to low-7 percent range over the past year, although initial yields may rise in the months ahead as prospective buyers underwrite deals for a slower pace of rent growth and a higher allowance for concessions.

- **Outlook:** Looking forward, investors will focus on multi-tenant properties in close-in submarkets, such as Chester County, with strong demographics and little expected competition from new space. Transaction activity will likely be dominated by private buyers who are encouraged by underwriting that is based on actual performance, rather than pro forma.



* Trailing 12-Month Period
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*** Data reflect a full 12-month period, calculated on a trailing 12-month basis by quarter.*

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Capital Markets

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

- After aggressively cutting rates earlier this year to stimulate the economy, the Federal Reserve held the fed funds rate steady at 2 percent during its August meeting. The headline rate of inflation increased by 1.1 percent in June, the second-largest monthly gain in more than 25 years, while elevated energy also began to bleed into the cost of core goods.

- While inflation remains a primary concern, the Fed is betting that persistent job cuts, the weak economy and declining commodity prices will keep wage pressures low and inflation in check in the months ahead.

- Lenders remain cautious and conduits are largely staying on the sidelines. Spreads for retail properties are currently 265 to 300 basis points over the 10-year Treasury with maximum leverage at approximately 75 percent. Lenders continue to pay particular attention to the type of retailer and tenants' credit quality when quoting terms.

- The yield on the 10-year Treasury rose to 4.2 percent early this summer but has since dropped below 4 percent. Through the rest of this year, the yield on the 10-year Treasury is expected to remain in the high-3 percent to mid-4 percent range.

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Submarket Overview

- Plans for the Valley Square shopping center in Warrington have been expanded to include a restaurant, two banks and a two-story retail building. The project, located at Street Road and Route 611 in the Bucks County submarket, is expected to come online in early 2009.

- Minimal new neighborhood/community center construction in Bucks County is expected to support a low vacancy rate in 2008. By year end, projected vacancy of 4 percent will result in effective rent gains of more than 1 percent, above the metro average.

- The $100 million Exeter Commons retail project received a state grant in July to defray the added costs of road improvements for the shopping center, helping to ease traffic flow and congestion to the site. The development is scheduled for delivery in Exeter next summer.

Submarket Vacancy Ranking

Rank	Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Effective Rent (psf)	Y-O-Y % Change
1	Bucks County	4.0%	-140	$19.32	1.3%
2	Montgomery County	4.4%	-220	$19.67	0.4%
3	Chester County	5.2%	-100	$17.10	1.4%
4	Delaware County	5.6%	110	$19.84	-0.4%
5	Gloucester County	6.3%	150	$13.43	-0.6%
6	Philadelphia County	6.9%	180	$18.63	0.1%
7	Burlington County	7.5%	-80	$19.97	-0.9%
8	Camden County	11.8%	110	$14.06	0.9%