2010 4th QUARTER CAP RATE REPORT

"Change starts when someone sees the next step."

— William Drayton

The story of cap rate movement in 2010 is a tale of two trends. Beginning with promise and an increase in NNN deal making, the year quickly faded in the wake of poor global economic news – only to rebound and rally around mid-year in select markets (headlined by New York and Washington D.C.). Overall, cap rates in the second half of the year were lower than the first. In fact, sellers of credit rated NNN properties in core markets closed at cap rates rivaling the 2007 peak of the market. Numerous reasons have been offered as the cause but chief among these were a lack of quality supply, a more positive lending environment and improving market fundamentals.

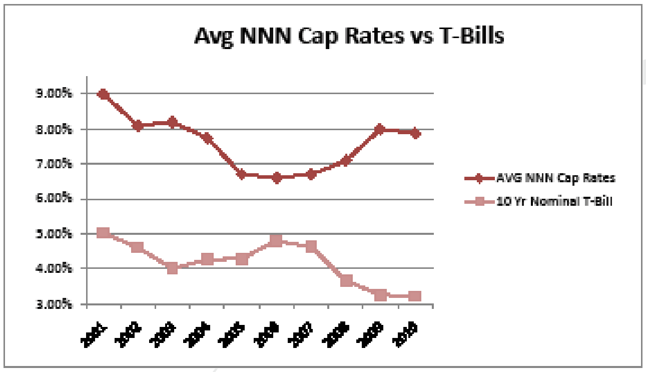
It is no secret that there was dramatic contraction in development over the past two years. The pause in expansion by national retailers coupled with stagnant retail sales and the tight debt market all but encouraged already wary developers to halt or slow projects slated for development. Those eager to invest quickly discovered that NNN properties were in short supply and properties of real quality in strong primary markets were even rarer still. In early summer, these factors created a dwindling pool of quality investment grade NNN assets.

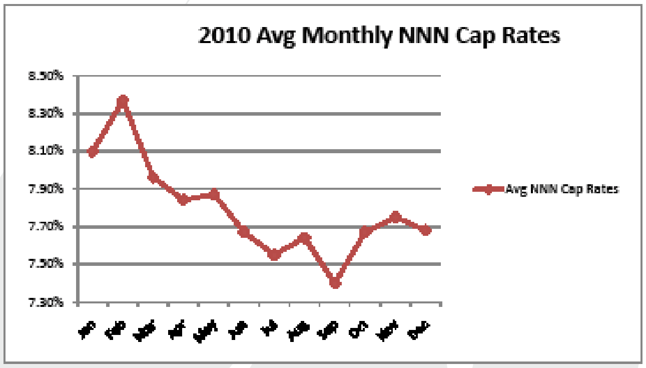
The global economy, at mid summer, was also feeling the impact of the financial crisis in Greece and the potential for instability and crisis within the European Union. Volatility was the key word as stocks rose and fell daily - motivating investors to look elsewhere for predictable and stable returns. Investment grade NNN properties in select primary markets were eyed by investors from around the world.

It is important to remember that credit rated NNN investment properties are essentially bond-like investments backed by the credit of the tenant *and* the underling real estate. That understanding became particularly important in the early summer of 2010. As NNN investors gained confidence in a slightly more open lending environment, competition for quality investment grade properties in these markets drove down cap rates and set the bar for investment properties of all types.

Towards the end of 2010, market fundamentals improved, becoming an important factor in the opening of the debt market and the drop in cap rates. Consumers in general tightened their belts over the course of the recession. The savings rate reached 6.4% in 2010 the highest level since June 2009 and by the end of the third quarter US non-financial corporations held a record $436 billion in cash reserves. Though unemployment continued to disappoint (remaining above 9%) the ever resilient US consumer warily began spending again in the latter half of 2010, helping to bolster economic forecasts. Economists disagree about the strength of the recovery, or even if there is a recovery, but recent indicators show promise - U.S. retail sales rose 4% in the 2010 holiday season and are predicted by ShopperTrak to rise 2.2% in the first quarter 2011.

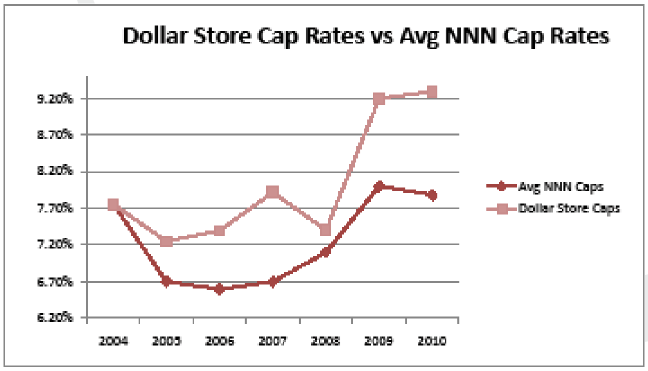
2010 AVG NNN CAP RATES





DOLLAR STORES

Dollar stores were perhaps the most well know beneficiary of the recession. As consumers shied away from higher end luxury items, bargain priced alternatives offered by dollar stores became attractive.



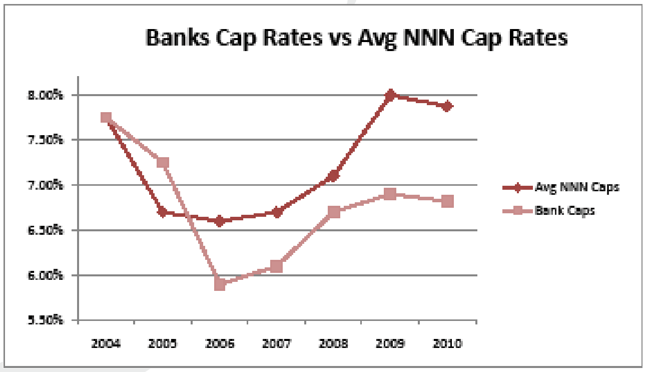
Though dollar store cap rates edged up from 2009 to 2010 – 9.20% to 9.29% – the increase was not significant. Cap rates in the first half of 2010 were markedly higher than latter rates – 9.35% to 9.24% – pointing to compression. To further illustrate this trend, Calkain sold a double-net Dollar General in June at an 8.75% rate. Calkain expects cap rates for dollar stores to continue to fall in 2011 as the smaller price point offered by this sector continues to attract a large pool of investors eager to compete for affordable net lease assets.

As noted in our early 2010 cap rate report, Dollar General Corp. has been moving to a more landlord friendly triple-net lease. The cap rate compression witnessed during the second half of 2010 is likely a direct result and signals the new pricing of these new triple net lease Dollar General stores. The triple net lease Dollar Generals are being priced in the mid-to-low 8% cap rate range, while the older double net lease assets have been trading at 9% plus cap rates. Other operators in this sector (e.g. Family Dollar, Dollar Tree) traditionally operate under a double net lease where the landlord is responsible for roof and structural maintenance and repairs. Based on Dollar General's growth and market appeal, it will be interesting to see if developers edge the other retailers in this sector to move towards the more landlord friendly triple net lease structure.

There is speculation about the staying power of the dollar stores but it is possible that the frugality brought on by the recession is a permanent theme helping to drive the performance of this sector.

BANKS

Although the financial sector has been rocked by heavy waves, NNN retail banks continue to be a top performer.



Bank properties are typically located on the best corners or in front of the busiest shopping centers. As a result, they often exhibit strong real estate fundamentals. NNN bank properties are often structured as ground leases where the landlord owns the land and the tenant retains ownership of the actual bank structure. Investors have historically shown a willingness to pay lower cap rates for ground leases, in part due to a strong sense of security in the investment given that the tenant made a sub-

CALKAIN COMPANIES, INC.

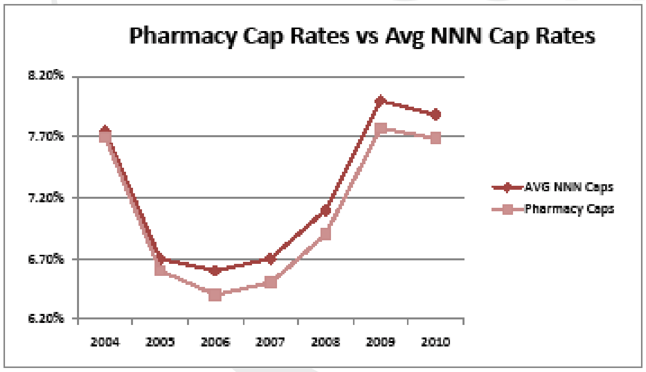
stantial capital investment in constructing the building.

Bank ground leases are also attractive to investors because they are completely free of landlord responsibilities, have a strong credit rated tenant and come with regular increases in rent that improve cash flow and the overall return on investment. There is another added benefit to a bank ground lease; at the expiration of the lease, the landlord takes possession and ownership of the building, further improving the return and potential value of the investor's initial investment. Additionally, mandatory quarterly reporting to the FDIC provides a level of transparency and view of location performance beyond other retail sectors.

The cap rates for bank properties continue to be the lowest out of all sectors and there is no reason to expect this to change. Like most sectors there was a profound difference between first and second half 2010 cap rates – 6.88% to 6.77% respectively. Calkain sold a BB&T in August with a 6.70% rate. Overall 2010 bank cap rates were also substantially lower than average NNN rates – 6.82% compared to 7.88%.

PHARMACIES

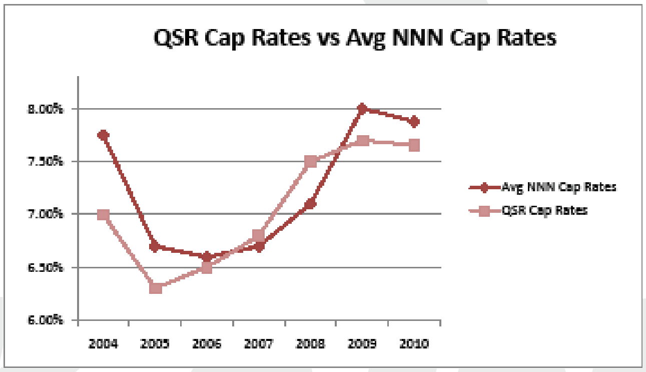
Another popular tenant has been pharmacies. The investment grade credit of top sector performers along with the market research, traffic analysis and ensuing solid nature of real estate fundamentals going into site selection make this sector very attractive to NNN investors. Headlined by high credit tenants such as Walgreens, there was a significant drop in the average cap rates in 2010 for this sector.



Average cap rates fell from 7.83% to 7.43% between the early and latter half of the year. In July, Calkain sold a Walgreens at a 6.85% rate. Pharmacy cap rates also continued their trend of remaining below average NNN rates, lending credence to their value as a tenant. It is worth noting that as with bank ground leases, ground lease cap rates for pharmacies on average trade 50-75 basis point lower than fee simple transactions.

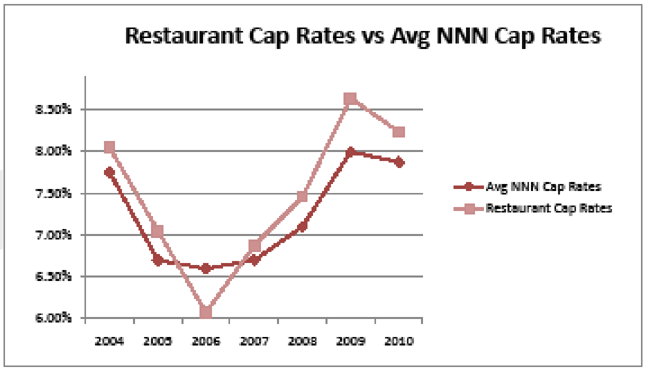
QUICK SERVICE RESTAURANTS

In both 2009 and 2010 QSR cap rates were lower than average NNN cap rates. Like most other sectors they also witnessed a decline from the early to latter half of 2010 – 7.78% to 7.60%. Some properties, like a Chick-fil-A Calkain sold in August, dipped as far a 6.00%. Spearheaded by high credit tenants like McDonald's, well-located QSR properties continue to be highly sought after. Brand recognition, strong property locations and, most importantly, tenant credit drives this sector.



RESTAURANTS

Many restaurant chains were hit hard by the recession. As people became more value focused, luxuries like dining out became less popular. However, there is evidence this trend is beginning to abate. Although the average restaurant cap rate remained higher than overall NNN cap rates in 2010 – 8.24% compared to 7.88% - there was a noticeable decrease between the first and second half of year. Restaurants cap rates fell from 8.24% in the beginning of 2010 to 8.17% in the latter half.

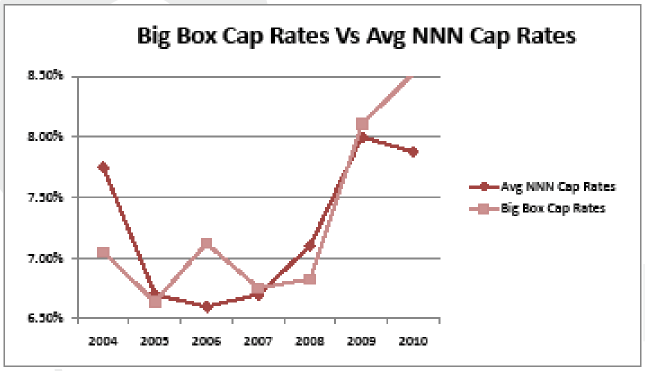


This trend could point to a return in economic normalcy as people begin to see dining out as a suitable option. There was also a large decline in cap rates from 2009 to 2010 – 8.64% to 8.24%. It is easy to speculate that a knee jerk reaction halting dining out expenses in 2009 began to abate in 2010.

Another interesting trend to take note of is difference between traditional and ground lease NNN properties. To illustrate, Calkain sold two Applebee's properties – one ground lease in June at 7.25% and one traditional NNN in November at 8.00%.

BIG BOXES

Big Box retailers typically occupy more than 50,000 square feet and derive their profits from high sales volumes rather than price mark up. The structures are generally windowless but occasionally include a front windowed curtain wall. Big Box retailers fill a number of market niches and offer low prices and great convenience – including discount department stores like Kohl's and Target and warehouse clubs like Wal-Mart and Costco. This sector has displayed exceptional growth in the past decade.



While the tenants have strong appeal and often carry a solid credit rating, the transaction size, acreage and square footage of the investment (larger on all fronts than the typical netlease investment) means that there is a more select pool of eligible investors for properties in this sector. Big Box retailers face serious challenges and there has been considerable contraction within the sector with the departure of some famous brands over the last 24 months.

CONCLUSION

Many predict the current movement in cap rates to be a temporary trend as investors chase yields not available in other fixed income investments and as more properties hit the market. New development is slowly underway but many of those properties are 6 to 18 months away from reaching the net lease market. Transaction volume was down in 2010 so it remains to be seen whether an influx of product will increase deal flow, temper the market and slow the compression of cap rates. Until then, lack of supply and increased demand continues to drive prices up and cap rates down, giving way to an indisputable fact – cap rates fell from 50 to 125 basis points depending on category and tenant credit in the second half of 2010.

FOR MORE INFORMATION

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