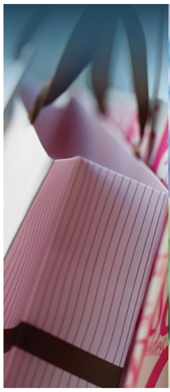

MARKETBEAT

TORONTO RETAIL REPORT

A CUSHMAN & WAKEFIELD RESEARCH PUBLICATION

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ECONOMIC OVERVIEW

It's all up to the consumer. It was, after all, conspicuous consumption that helped drive the world into what was arguably the worst recession since the 1930s. Will shell-shocked consumers recover their confidence and lead the world back to an era of growth?

Not likely, the experts said just a few months ago. Faced with the imminent threat of losing their jobs and having seen their nest eggs evaporate, consumers, especially those in the U.S., were tightening their belts and hunkering down. Economists called it a new era of frugality, a once-in-a-generation change in culture and values. As it turns out, consumer values are not quite as easily transformed as the economists imagined. Underneath it all, people like to shop. That's what makes them consumers. Despite lingering feelings of insecurity, after a year of self-deprivation consumers started to spend again. Analysts dubbed it "frugality fatigue".

Whether it is a result of a renewed sense of confidence or just pent up demand, the expected increase in consumer spending in the coming months will be crucial, as Bank of Canada Governor Mark Carney pointed out recently when he urged consumers to pick up the slack as government stimulus spending starts to wind down.

Consumers are responsible for about 70 percent of overall spending and Canadian consumers, not as badly shell-shocked as those south of the border, seem willing to do their bit. Retail sales rose in October 2009 for the eighth month out of the past ten, and sales were up by 0.8% over the previous month to $35.3 billion, heralding a positive start to the traditional holiday rush. Led by sales of new cars, which jumped 3.6% in October, the retail gains were broadly based, with sales at clothing and accessories stores advancing 1.9%. By December, according to the Conference Board of Canada, consumer confidence had risen 3.7% to 82.8 points, with Ontario seeing a significant gain of 7.5 points.

After shrinking about 2.5% this year, the domestic economy is expected to grow 2.4% in 2010 and 4.0% the year after that, driven by stimulus spending, improving credit conditions and consumer spending. Canadian consumer spending is expected to increase by 2.3% next year and 2.7% in 2011.

Whether this will translate into an upsurge in the retail real estate sector remains to be seen. By June 2009, retail vacancy rates in Toronto had increased to 10.5 percent, up more than two percent over June 2008. At the same time, Canadian developers were adding retail space at a record pace. In the first half of 2009, developers opened more than 6.8 million square feet, more than was opened in all of 2008. With much of the space preleased, developers and retailers are betting that frugality fatigue is here to stay. The question is whether or not consumers agree.

ECONOMIC INDICATORS - ONTARIO

	2008	2009	2010F
Real GDP Growth	-0.5%	-3.2%	2.4%
CPI Growth	2.3%	0.3%	1.3%
Retail Sales	3.5%	-2.7%	3.8%
Housing Starts	10.9%	-33.8%	30.0%
Employment	1.4%	-2.4%	1.1%
Unemployment	6.5%	9.1%	9.7%

Source: RBC Economics Research, 2009

KEY LEASING TRANSACTIONS

TENANT	PROPERTY	SQ.FT.
Joey Restaurant	Shops at Don Mills	9,000
Glow Fresh Grill & Wine Bar	Shops at Don Mills	8,500
Apple Computers	Square One Shopping Centre	5,800
Pink by Victoria's Secret	Vaughan Mills Mall	5,000
Pusateri's	Bayview Village	5,000
M for Mendocino	Yonge Eglinton Centre	2,000
Popeye's Chicken & Biscuits	539 Yonge Street	2,000
Michael Kors	Shops at Don Mills	1,800

KEY INVESTMENT TRANSACTIONS

PROPERTY	SQ.FT.	PRICE
1475 Dundas St E, Mississauga	60,549	$10,600,000
16700 Bayview Ave, Newmarket	72,150	$9,500,000
3362-3370 Yonge St, Toronto	12,250	$8,940,000
106-120 Orfus Rd, Toronto	72,764	$7,200,000
10220 Derry Rd E, Milton	22,935	$6,000,000

BEAT ON THE STREET

"The market remains strong, with well capitalized investors hungry for Toronto product. The unrelenting influx of population moving into downtown condos will continue to add traffic and customers to retail shops. Another stimulating retail trend was the "pop up" shop—this emerging trend was popularized in New York's Soho, where merchants would open in an often edgy or obscure location for one week to a month, generating buzz. Holt Renfrew opened one in the Fashion House condos on King Street West., and we expect to see more of this exciting trend in 2010."

– Arlin Markowitz, Sales Representative

The End of Frugality?

A year ago, Harry Rosen, the high-end men's clothier, saw holiday sales fall more than 15% from the previous year. Anticipating that this year would be no better, the chain cut back inventory levels by about 5%. It is now scrambling to keep up with demand and running out of $1,500 suits and $450 jeans. The change started in October, Harry Rosen told the Globe and Mail, and sales at the chain's store in the heart of Toronto's financial district are up 20% over a year ago – an increase all the more surprising considering that rival Brooks Brothers opened a new store nearby only a couple of months earlier.

At the same time, the Bay was betting that women would appreciate a more elegant approach to shopping. In October, it relaunched The Room at its flagship store at Queen and Yonge. Dating back to the 1930s when it was known as the St. Regis Room at Simpson's, The Room underwent a $5.3-million refurbishment. The Bay expanded the size of the space more than five-fold to 21,500 square feet (sf), added a VIP lounge, and increased the number of upscale brands from 12 to 70. The Room will have 25 staff and a full-time concierge. The Bay anticipates that in the first year alone, The Room's sales will triple to $15 million.

While, according to Cushman & Wakefield's "Main Streets Across the World" report, more than half the most prestigious shopping streets in the world (including New York's Fifth Avenue, the most expensive retail street in the world) have seen retail rental rates decline, Canada is one of the exceptions. Its two most expensive shopping districts, Bloor Street in Toronto and Robson Street in Vancouver, are still seeing solid demand.

TOP TEN LOCATIONS IN THE AMERICAS

CITY	LOCATION	U.S./sq.ft./yr
New York	5th Avenue	$1,700
New York	Madison Avenue	$875
New York	East 57th Street	$800
Los Angeles	Rodeo Drive	$500
Chicago	North Michigan Avenue	$400
San Francisco	Union Square	$400
Sao Paulo	Iguatemi Shopping	$352
Chicago	East Oak Street	$350
San Francisco	Post Street	$350
Toronto	Bloor Street	$260

Source: Cushman & Wakefield Ltd., "Main Streets Across the World", 2009

A Dollar Saved is a Dollar Earned

While Canada's more affluent consumers may have tired of pinching pennies, not everyone can afford to spend $250 on a dress shirt or $600 on a cashmere sweater, which is why Bargain Shop featured a $20 sweater on the front page of its flyer in September.

Known primarily as dollar stores, discount chains are broadening their offerings and shifting to pricier products in an attempt to attract more affluent customers who, nevertheless, appreciate the need for frugality. Once considered to be at the lowest end of the consumer food chain, discount chains are now offering high profile brands and private labels that offer popular styles at low cost, and a broad selection of food.

Dollarama started to raise its prices last February and now 24% of its goods are priced at more than a dollar. At Bargain Shop, the average purchase size has increased about 10% in the past year while Giant Tiger's average sales are now over $20.

Discounters thrive because they are able to pass on cost savings to their customers and suppliers, searching for new outlets and, after losing some of their traditional retail customers, have sharpened their pencils. The discounters also keep their real estate costs under control, leasing less prominent spaces at rates that can be as much as 50% less than conventional retailers pay.

And it is not just consumers that are finding discounters attractive. The chains are also attracting new investors. Dollarama raised $300 million in the third-biggest initial public offering in Canada this year. Founded in 1992, the chain has 585 locations across Canada and revenue of about $1.3 billion.

Saying Goodbye

By the end of 2009, the recession had taken its toll on a number of fabled retail names. In September, Tall Girl, launched 50 years ago in Calgary, declared bankruptcy with debts of about $5 million. The chain had 31 outlets, including 17 U.S. stores (one of the few Canadian chains to succeed in expanding into the United States), with annual sales of about $25-million but, even before the recession hit, its stores were considered dated.

Syd Silver, Canada's leading tuxedo retailer, closed its 17 stores in December after more than 80 years in business. A victim of increasing competition and a shrinking marketplace, the company owed $4.5 million.

Dack's Shoes, one of the country's best-known retailers of men's footwear, also declared bankruptcy in December, closing all six of its stores, a result, a store spokesperson said, of declining market share and increasing overhead costs compounded by the recession. Matthew Dack founded the business in Toronto in 1834.

In December, McNally Robinson Booksellers closed its money-losing Don Mills store as part of a bankruptcy restructuring. The independent bookseller launched its Shops at Don Mills mall outlet in April. The 20,000-sf Toronto store included an 80-seat restaurant.

Toronto Life Square, at the heart of Toronto on Dundas Street (the city's homage to Times Square in New York), went into receivership in April, the city's first major casualty in the downturn of commercial real estate. Opened in 2008, the 13-floor building has four levels for shopping, including a large FutureShop and a 24-screen AMC cinema. The building has 46 tenants paying about $13 million a year in rent but the developer had debts of almost $280-million. The property is currently up for sale.

Other notable departures include the 20-year old Toronto-based Chinese food chain Ho-Lee-Chow, which blamed the poor economic climate for its closure; and Toronto's Hard Rock Café, which will not be renewing its lease at the Rogers Centre at the end of 2009.

Saying Hello

While expansion was the farthest thing from most retailers' minds, a few companies gazed into their crystal balls and spotted a glimmer of opportunity.

In October, Victoria's Secret opened its first four Pink lingerie outlets in Canada. It's a market that the parent company, Limited Brands, which operates about 3,000 outlets, mostly in the U.S., knows well. In early 2007, it bought Canada's leading lingerie retailer, La Senza, which has more than 300 outlets across the country. The Canadian underwear market is reported to be worth about $2 billion and is expected to grow by about 40% by 2013. Limited Brands is also expanding its chain of Bath & Body Works, launched last fall, from 20 to 30 outlets.

Linens 'n Things, which filed for bankruptcy last year, will re-emerge as a Home Outfitters label in 2010.

In August 2009, Brooks Brothers opened its flagship store in the Royal Bank Plaza in the core of Toronto's business district. One of three stores planned for its Canadian expansion, the 22,000-sf store is aimed at the high-end Toronto consumer, described by Brooks Brothers as similar to those in New York but with a more European flavour.

Lowes continues its slow but steady expansion in Ontario, opening its first store in the Ottawa area in December. It now has 16 outlets in Ontario and plans to open 10 new Canadian stores a year for the next few years. At that rate it will, however, take more than a few years for Lowes to catch its chief rival, Home Depot, which now has 180 stores across Canada.

Leon's, the iconic Canadian furniture chain with 64 outlets, is also looking to expand but has changed its strategy. Leon's has traditionally bought land and developed its own stores, usually with large warehouses attached, a process that can take up to four years to bring to fruition. It is now looking at vacant commercial space, at lower cost thanks to the recession, for up to 15 new stores. The new stores will be considerably smaller, between 5,000 and 8,000 sf, but without attached warehouses so they can fit into more urban locations and will be considerably quicker to bring on-line.

Telus Corp bought Black's Photo Corp. and its 113 Canadian stores in September, in a deal worth about $28 million. Telus said that it saw a natural link between Black's Photo and Telus' wireless products and services. Earlier this summer, Bell Canada had made a similar move, buying The Source, a chain of 750 stores from bankrupt Circuit City. Bell paid about $135 million for the chain in a move that is designed to boost sales of Bell and Virgin Mobile wireless products.

The new kid on the telecommunications block, Globalive Communications Corp.'s Wind Mobile, will soon join Telus and Bell in the retail market. Wind Mobile, which aims to become Canada's fourth major cell phone provider, launched its service in Toronto on December 16. The company is opening six stores and 13 kiosks in Blockbuster video stores in the Greater Toronto Area.

Here Today, Gone Tomorrow

Have some empty retail space for lease? Why not cash in on the newest retail fad: pop-up stores.

Pioneered by Comme des Garçons a few years ago in Europe, pop-up stores open with great fanfare in a retail location, create some retail buzz and then shut down a few days or weeks later.

Originally a strategy for small designers and retailers to gain some notice, large retailers are now latching onto the concept. In December, Holt Renfrew opened Toronto's first fashion pop-up store for five days in the King West Fashion House, generating enormous publicity and presumably gaining some generous pre-Christmas sales.

Robin Hood Flour has also jumped on the bandwagon, opening a pop-up bakeshop. Conceived and designed by Toronto-based Ogilvy, the store opened at the beginning of November on Eglinton Avenue. It featured a giant pink rolling-pin-shaped table where consumers can try their hand at baking their own goodies.

Community Focus

Hit hard by competition from power centres and big box stores, mid-range enclosed shopping centres, many of which were built in the 1960s and 1970s, have been trying to attract consumers by investing in community-based marketing. In St. Thomas, a small Southwestern Ontario city, the Elgin Mall, owned and operated by Toronto-based Retrocom Mid-Market REIT, has sponsored local hockey and soccer teams, held food drives, staged fashion shows and opened up meeting space for non-profit organizations, all of which helped increase foot traffic and sales.

According to one retail analyst, a renewed focus on the community helps consumers, tired of shopping on-line, reconnect to a more leisurely and enjoyable shopping experience in the comfort of an enclosed mall. In fact, the loss of a major anchor tenant can actually provide an opportunity for developers to generate a more focused community approach and increase revenue by drawing in smaller retailers at higher rents to occupy the vacant space.

Another mall with a renewed sense of community is Toronto's Dufferin Mall, which recently completed a three-year, $11-million re-launch. Located on Dufferin Street, the mall was home to low-end retailers, dated décor and an unsavoury reputation. Cashing in on the gentrification of the area, the mall now offers a modern décor, free Wi-Fi in the food court, and new retailers including Urban Planet, Costa Blanca, H&M and Aéropostale.

At the other end of the scale, affluent consumers now have a chance to experience the sense of community that they once had strolling down Main Street. Toronto's only lifestyle shopping centre, the Shops at Don Mills, which opened in April, recreates the downtown experience in a suburban setting. With 101 stores and 450,000 sf of retail space, it cost Cadillac Fairview about $20 million more to build than a regional mall, but the open air design is less expensive to operate than an enclosed mall.

Shopping on the GO

The City of Toronto has selected Osmington Inc. to manage the development of 160,000 sf of new retail space at Union Station, which is currently undergoing a major renovation.

Osmington has been given a 50-year lease and an option to renew for another 25 years. Construction of the five-year project is scheduled to begin this spring.

Retail Real Estate Investment

The third quarter of 2009 saw 42 retail real estate transactions in the Greater Toronto Area with an aggregate value of about $155 million. Approximately half the transactions were in the city of Toronto.

Retail real estate sales in the Greater Toronto Area for the year ending in the third quarter of 2009 amounted to about $650 million, of which about 70 percent of the volume was for retail properties smaller than 30,000 square feet.

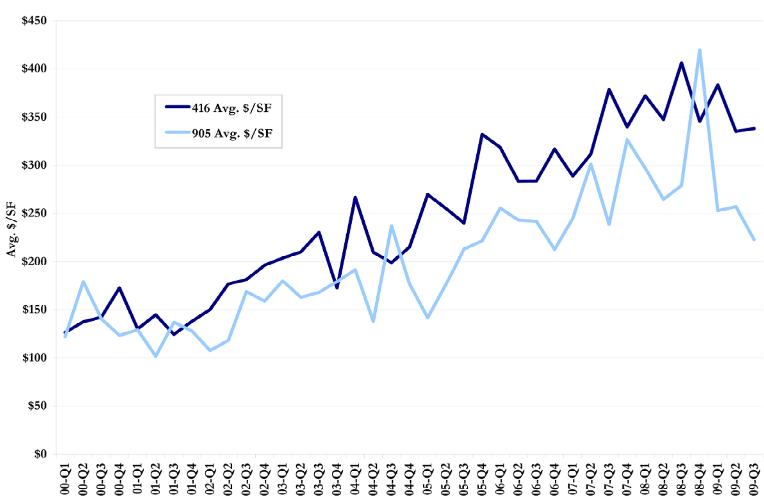
Based on the average price per square foot within the City of Toronto, retail properties have held their value despite the recession. In the third quarter of last year, the average transaction was just below $350 per square foot, down from a peak of $400 a square foot a year earlier but relatively unchanged from values in 2007 and almost triple the price for retail real estate in 2001.

The picture was a little less optimistic for sellers in the suburban 905 area. By the third quarter of 2009, sales prices had dropped to about $220 per square foot from a peak of $420 a square foot a year earlier.

With the cost of real estate increasing steadily over the last decade, cap rates have decreased in inverse proportion. In 2000, for example, with the average cost of real estate at $150 per square foot, cap rates were just under 10 percent. By 2008, real estate transactions in the GTA had peaked at $350 per square foot and cap rates were down to 6.6%.

In the last year, with average GTA property transactions declining on average from $350 per square foot to $300 square foot (a decline of about 15%), cap rates were on the increase for the first time in almost a decade, closing out Q3-2009 at 7.6%.

AVERAGE $/sq.ft. – 416 vs. 905
GREATER TORONTO AREA – 2000 TO Q3 2009



Source: RealNet Canada, 2009

Embrace the Change

In a recent interview with Monday Report on Retailers, Willy Kruh, global chairman for consumer markets and Canadian partner for the consumer markets industry segment at KPMG, offered some cogent observations on the current retail market:

On the retail landscape in 2009... Retailers had not planned for the recession. They didn't have time to adjust inventory and the reduction in consumer confidence and spending meant more markdowns.

On the holiday shopping season... Retailers have done a good job in planning for inventory levels based on consumer spending and the uncertainty of what was ahead… with tighter inventory levels than in a long time.

On consumer spending... 2010 will be better than last year. In Canada, the economic climate and consumer confidence is higher than in the U.S., so you've got a little more optimism in Canada and the economy is probably a little bit more stable.

On retailers embracing the changing consumer... Retailers have got to embrace the change. Consumer perceptions of value are shifting... basically consumers want value and want it all possible ways: price, quality, and service.

On social networking... Social networking can't be ignored anymore… designers are putting applications on iPhones to sell merchandise; Twitter feeds listing discounts and online coupons; all sorts of mobile apps are emerging. It shows you the power of social networking and expanding product awareness and store awareness using different modes of communication.

On adapting to the evolution of retailing... The discounters had a winning year and I don't think their gains in market share are going away. Companies need to create value products... even the highest-end retailers. They need to make online shopping easier and more dependable. Department stores are getting more aggressive because they have to. Even the luxury market is trying to be resilient--it got hit hard, but you're seeing a little bit of an upturn.

On retailers positioning themselves for 2010... If some of the retailers have a strong balance sheet and have managed their business well, then they are in the forefront. There's great real estate available and they can own their market. On the flip side, the weakness in the economy, primarily in the U.S. economy, means that many retailers still have to plan for a tough 2010.

Retailers can win in that tough year by being creative and embracing the change; understanding the new customer; understanding technology and innovation; really meeting the needs of the consumer; and using everything in their disposal to win in the marketplace.

For industry-leading intelligence to support your real estate and business decisions, go to Cushman & Wakefield's Knowledge Center at www.cushmanwakefield.com/knowledge

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