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Why Grocery and Necessity-Anchored Retail?

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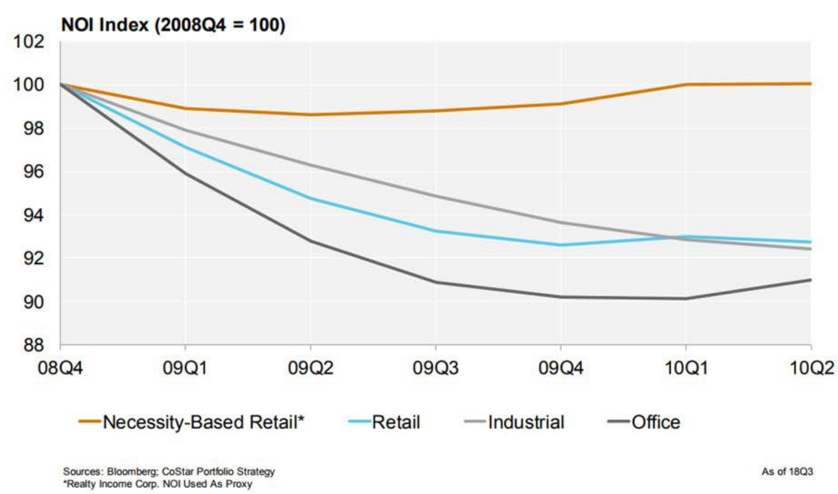
Grocery and necessity-anchored retail is one of the more attractive and defensive investments in real estate because of the following: well-occupied centers generate consistent and considerable cash flow throughout market cycles, grocers draw shoppers to the centers several times a week, generating consistent cross traffic for other tenants, and with the right grocer and tenant mix these centers can be operated to maximize the potential lift from changes in technology while minimizing the negative impact.

Grocery anchored retail has proven to be a strong performer during recessions, a favorable characteristic when making late-cycle investments. Relative to other forms of retail grocery sales are remarkably stable; sales growth rarely exceeds the broad swath of retail but they rarely decline. During the GFC, the NOI generated by grocery-anchored retail as a sector was slightly positive. This not only outperformed all other types of retail but most every other type of real estate, proof positive that consumers will continue to shop for food and other necessities while cutting back on other discretionary purchases.

NOI TRENDS BY PROPERTY TYPE DURING THE GREAT RECESSION



The grocery anchor serves as a draw to the center which accrues to the benefit of the rest of the center's tenants. These retailers want to be located near a strong anchor, so not only does the grocer help boost occupancy, but with the benefit of cross-traffic overall sales should be strong as well. Fitness centers now want to be near a grocer for the sake of convenience; dry cleaners, salons, fast casual restaurants, and medical-related tenants such as dentists and urgent care centers – all of whom are resistant to e-commerce as well as the vagaries of economic cycles – want to be located near a grocer who will draw shoppers to the center on a consistent basis. The average U.S. consumer makes a trip to the grocery store 1.5 times per week (Brick and Mortar is Alive and Well). For this reason, it is estimated that most consumers in the U.S. have a grocery store located, on average, within two miles from where they live. And for this same reason, other retailers want to be located within the same center as a grocery store, resulting in the fact that grocery-anchored centers currently have the highest occupancy rates of all shopping center types nationally.

The threat to retail from e-commerce is real and cannot be understated. The threat to grocers from e-commerce is less so but still an ominous cloud on the horizon. Currently, e-commerce constitutes just over 2% of total grocery sales, versus 9.9% for the broader retail market. CBRE estimates that even with 20% annual growth, grocery e-commerce will reach 5% market share by 2022, altering but not replacing traditional store sales. High customer product interaction helps make grocery and necessity-anchored retail the sector with the lowest risk from ecommerce in U.S. retail.

But changes in technology also present an opportunity for grocers, especially for the dominant players who have the capital to evolve. There is a real chance that e-commerce will lead to the demise of many forms of retail including weaker grocers, but for the larger players there will be opportunities to consolidate and/or remove competitors from the landscape. As these grocers consolidate their position in the market, the value of the center in which they are located will increase, while centers with weaker grocers in lesser locations may well suffer.

For those grocers who can embrace technology, the ability to expand on online shopping with curbside or in-store pickup (click-and-collect) can improve their offerings to customers, weaken competition, and provide yet another lure to shoppers for the overall center. Technology for these grocers will allow them to improve customer offerings, decrease the costs of operating a store (robots, cashier-free checkout, etc.) and change the overall experience for a customer – yet all the while remaining as a completely relevant and necessary format which draws consumers to a shopping center, day in and day out.

Despite the strong fundamentals throughout the economy, whether measured by wage growth, low unemployment, consumer confidence, etc., retail as a whole has experienced almost no development, and this applies to grocery-anchored centers as well. Ground up development in 2019 will reach a record low in retail. Vacancies will continue to fall in 2019 after falling in 2018, and net store openings (despite the headlines) will outnumber closures in 2019, boosting demand and driving up rents.

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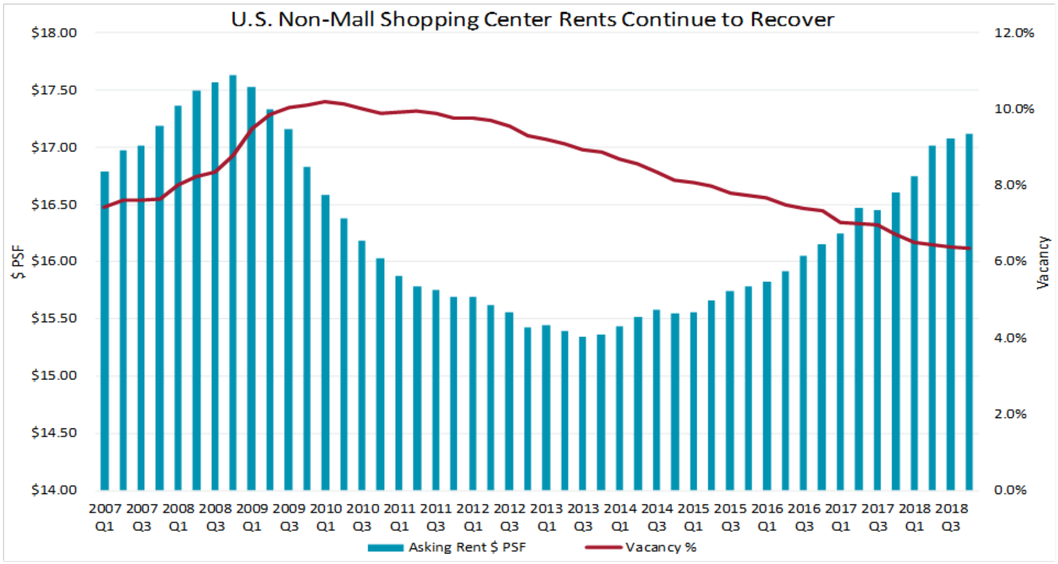

Source: Costar Group, Cushman & Wakefield Research

The net beneficiary of all of this is the owner of the center. And despite those positive fundamentals, grocery-anchored strip centers continue to see (or benefit from, depending on one's perspective) expanding cap rates. Cap rates for Strip Center Retail have recently risen while most every other sector has fallen. Driven partially by cyclical concerns but mostly by a reaction to negative headlines, not only does this create an attractive buying opportunity but it could insulate retail from a dramatic repricing should real estate cap rates reverse course due to a recession.

Pricing for grocery and necessity anchored retail peaked around 2015 in the United States. Current pricing on many core + and light-value add assets are around 10-30% lower than they were during the peak years of 2015-2016. Managers that invested heavily in this space in that same time frame may be having a hard time exiting their assets at accretive pricing. With the significant discount to peak pricing in grocery and necessity-anchored retail that we see now in 2019, groups that invest in these types of assets should increase their ability to see favorable exits if pricing and cap rates normalize in the medium term.

The Company

AmCap was founded in 1979 as an owner/operator of grocery-anchored and necessity-driven retail shopping centers. Since its founding AmCap has maintained a focused investment strategy: acquire stabilized or semi-stabilized shopping centers at a discount to market, then with its in-house asset management and leasing teams work to create value. By improving occupancy, optimizing tenant mix, and improving the overall operations of the center AmCap expects to drive higher sales, and with that, higher rents and overall NOI from the Center. AmCap invests in properties situated in the top 100 MSA's in the U.S., predominantly those demonstrating strong job growth, higher income and densely populated neighborhoods with high barriers to entry. The firm has made 61 investments in its history, and is led by a seasoned team, including the founder Jay Kaiser and a group of senior leaders averaging 20 years with the firm. As of December 31, 2018, AmCap owns approximately 5 million square feet of retail shopping centers across the U.S., with approximately $1.0 billion of assets under management "AUM".

The Authors

Jake Bisenius, JBisenius@amcap.com - Jake joined AmCap in 2005 and heads the company's day-to-day activities as President and Chief Investment Officer. He is a member of the firm's Investment Committee. Jake's tenure in the real estate industry spans nearly two decades, and he has handled more than $2 billion worth of real estate transactions during his career. Prior to AmCap, he worked at Vornado Realty Trust in Acquisitions & Capital Markets, focusing on equity and mezzanine loan real estate investments in retail, office, and hotel. Jake received his Master of Business Administration from Harvard and graduated summa cum laude with a Bachelor of Science in Mechanical Engineering from the University of Wisconsin. Jake is an active member of the Young Presidents' Organization (YPO).

Stephen Chase, SChase@amcap.com - Stephen joined AmCap in 2019 as Managing Director of Investor Relations. He is responsible for leading business development opportunities and furthering the growth of AmCap's institutional investment platform. Prior to joining AmCap, Stephen spent five years as a managing director at PCCP, a real estate investment firm, where he was responsible for raising capital for that firm's investment platform. Before joining PCCP, Chase served as a director in the private fund advisory group at Lazard Freres & Co. Mr. Chase graduated from Yale University, where he received a bachelor's degree in history.