Marcus & Millichap

Special Report

First Half 2018

Toys R Us Liquidation

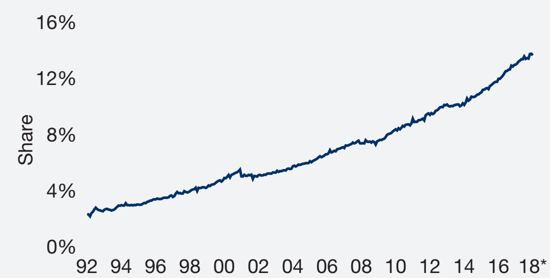
Toys R Us Downfall Reiterates Changing Retail Climate; Potential Retail Replacements to Emphasize Experiences

New age of retail forces adaptation. The rapidly evolving retail landscape bypassed Toys R Us, resulting in a bankruptcy protection filing and ultimately the announced closures of roughly 800 locations. Well-established brands shuttering stores have become a common theme in recent years as companies who fail to adapt to the new retail reality operate with outdated strategies. The company's weakened balance sheet hampered efforts to make investments to modernize its business model and compete with Amazon, Walmart and Target. Due to the firm's limited online capabilities and inability to transform into an experiential retailer, consumers soon found quicker and cheaper ways to purchase toys that bypassed this traditional toy powerhouse. Strong Internet competition led to Toys R Us' diminishing market share and the competitive gap slowly widened until it was beyond the company's ability to bridge.

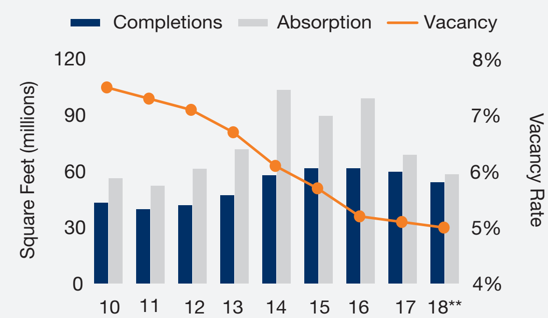
Vacated space a boon to some investors and retailers. Markets with low retail vacancy and large Toys R Us footprints may be positively impacted by the company's liquidation. The soon-to-be vacated stores could bring much needed retail space to the market. In metros like Boston and Pittsburgh where vacancy is forecast below 3.5 percent this year, tight market conditions hinder retailers' expansion efforts. An influx of space coming available in San Diego and Northern New Jersey could also provide relief to retailers struggling to find locations, particularly in San Diego due to its thin retail completions over the past several years. Conversely, metros with high vacancy could encounter new challenges from the addition of available space. Riverside-San Bernardino, Houston and Detroit face this risk; more than 420,000 square feet of Toys R Us space will soon be vacant in each metro.

Moving rents to market could be silver lining for some investors. Due to the lengthy leases of many Toys R Us locations, the closures will give landlords opportunities to adjust rents to match current market conditions, as many of the lease agreements include below-market rates. The ample amount of space anticipated to come online in the following months should support more competitive rents in neighborhoods most affected by the company's liquidation. Landlords will soon have the option to choose a tenant better positioned to compete in the dynamic retail climate. Although the number of retailers targeting 30,000- to 40,000-square-foot locations is limited, many retailers capable of filling these spaces have reported strong performances in recent years and are seeking expansion.

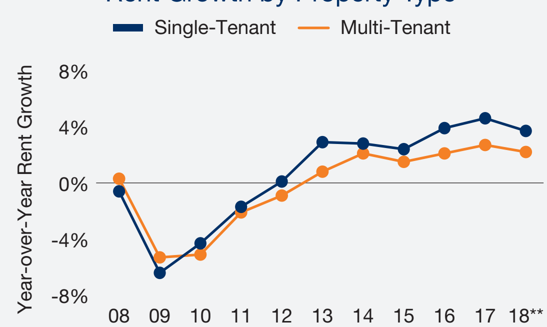
E-Commerce Share of Core Retail Sales



Retail Supply and Demand



Rent Growth by Property Type



* Through Jan 18
** Forecast

Sources: Marcus & Millichap Research Services; CoStar Group, Inc.; U.S. Census

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Strong Group of Retailers Expected to Show Interest

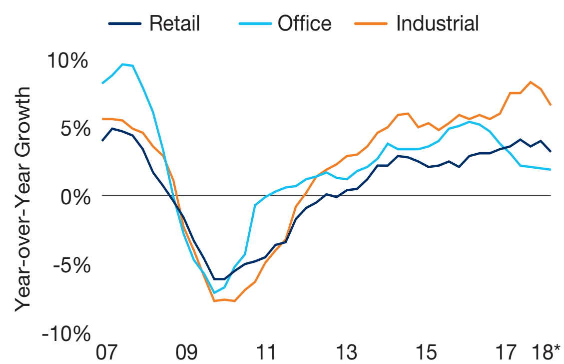
Vacant Toys R Us stores will present companies with opportunities to broaden their footprint and gain market share in their respective industries. Fitness centers have been expanding at a rapid pace as they attempt to keep stride with the growing health-conscious community. Gyms act as a junior anchor for strip malls and power centers due to their propensity to increase foot traffic. Expanding grocery chains could potentially seek some of the dark locations as they are the ideal size for many companies. Grocer brands with traditionally larger layouts may also target the shuttered stores as they shift to smaller formats attempting to maximize sales per square foot. In 2017, supermarkets' net store growth was the fifth highest out of 10 retail segments with 674 new locations. Discount retailers like Ross and T.J. Maxx are also feasible tenants as they have some locational flexibility due to their brand-based consumer appeal.

Landlords to Adapt to Evolving Marketplace

With retail continuing to evolve at a brisk pace, filling the soon-to-be vacant Toys R Us locations may require improvisation. The inability to occupy the entire space with one retailer may result in subdividing the space into multiple sections; however, bay depth could present a challenge. Converting retail assets to offices or last-mile distribution centers are also concepts that have generated interest in recent years as owners search for ways to adapt locations and maintain a steady revenue stream. The larger co-branded Toys R Us/Babies R Us stores, typically averaging about 65,000 square feet, could have particular appeal as last-mile fulfillment centers, depending on truck access, bay height and foundation structure capacity. Although uncertainty surrounding the filling of the eventually vacant locations is imminent, expect investors to capitalize on the new space coming to market and the demographics contributing to commercial real estate's strength.

2017 Net Store Growth

Rent Growth by Potential Replacement Type



*Forecast

Largest Toys R Us Footprints

Market	Store Count	Square Footage	Retail Vacancy*
Los Angeles County	21	754,685	4.1%
Northern New Jersey	18	597,754	3.7%
Washington, D.C.	16	562,858	4.7%
Atlanta	13	438,490	5.4%
Detroit	12	437,384	6.2%
Dallas/Fort Worth	11	426,489	4.9%
Riverside-San Bernardino	10	426,006	7.8%
Houston	16	424,097	6.0%
New York City	15	422,340	4.8%
Boston	14	391,253	2.5%
Pittsburgh	11	362,601	3.3%
San Diego	12	351,138	3.5%
United States	**~800**	**23,412,531**	**5.0%**

* 2018 Forecast

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Price: $500

Sources: Marcus & Millichap Research Services; CoStar Group, Inc.; CreditNtell; IHL Group; U.S. Census