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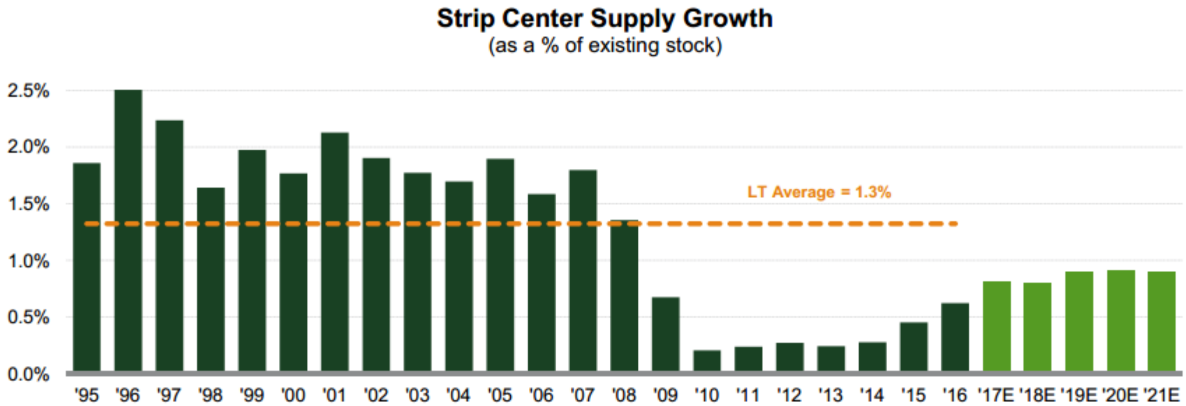
2017 was not the year of the retail apocalypse. Reading the newspaper headlines would have caused one to expect all retailers to be out of business by year-end, with all the country's enclosed malls and open-air shopping centers slated for demolition. Yet, the reality is far different. While there was certainly shake up and change in the industry, some positive and some negative, we don't believe the apocalypse is upon us. Non-store sales account for approximately 9% of retail sales, and only about half of that comes from pure-play e-commerce retailers (the other half includes items such as shipping charges for online orders, mail order and online orders from brick and mortar retailers). We believe that high quality brick and mortal retail will remain relevant.

The retail environment, particularly in our niche, remains healthy and we have seen a strengthening over the past few months with some of our largest tenants. Many of these major tenants, such as TJ Maxx, Ross Dress for Less, Five Below and Ulta, are continuing to open a significant number of stores. In fact, as shown in the chart below, there are many retailers that are expanding their brick and mortar footprint. Most articles have noted the number of store closures in 2017, but those articles fail to mention the fact that there were 2.7 openings for every closing during the year (net openings were expected to be 500-1,000 stores in 2017, which is in-line with the 10-year average).

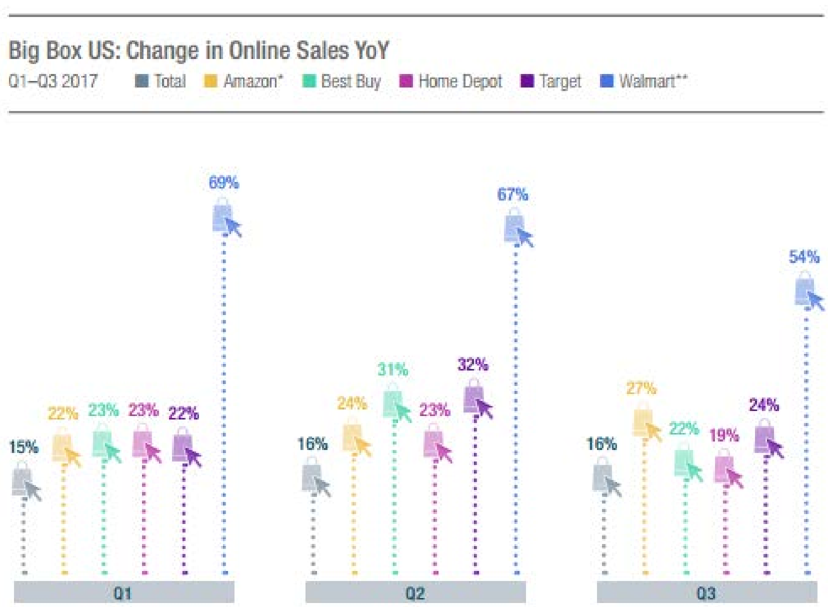
Source: CoStar, Cushman & Wakefield, Kimco Realty

This is also reflected in the continued high occupancy rate for quality retail real estate, particularly in the category of stores over 10,000 square feet. While new store openings have contributed significantly to these occupancy rates, the lack of new supply has also played an important role. As illustrated in the chart below, new supply has run approximately 0-1% since 2009, significantly below historical averages.



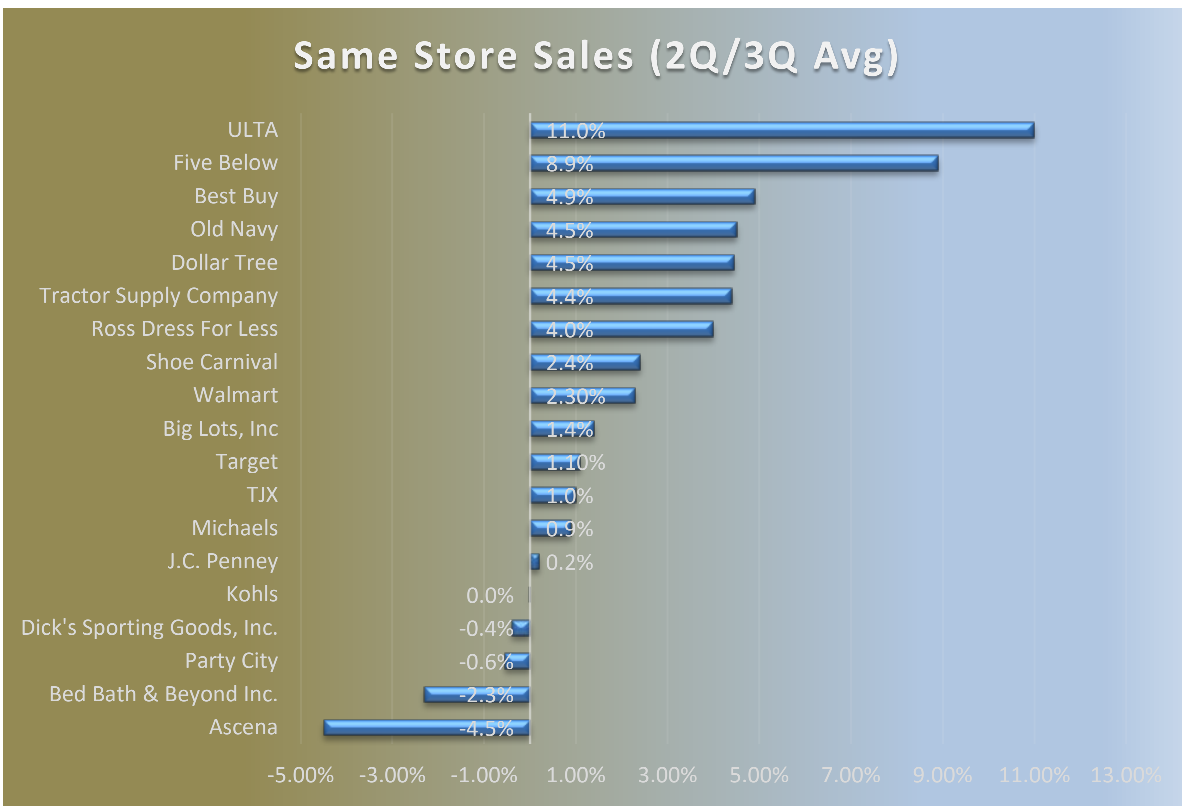
Source: Green Street

Many of the retailers that are thriving today are ones that have embraced and invested in their omni-channel platform. In fact, the fastest growing online retailers today are brick and mortar companies, such as Walmart, Target, Home Depot and Best Buy, all of which are growing their e-commerce businesses at a faster pace than Amazon (see chart below). These retailers have seen success by merging online and brick and mortar to create a seamless customer shopping experience. As an example, Target recently announced that stores fulfilled 70% of their online holiday sales (in-store pickup and ship from store), with stores enabling 80% of their comparable sales growth. Walmart has been another leader in the omni-channel strategy, with over 140 of its stores now participating in in-store pickup of online grocery orders. A recent research report by the Tesley Advisory Group noted that "an omni-channel customer spends more than a single-channel (in-store or digital) customer. Walmart has said an omni-channel customer spends $2,400 a year versus an average store-only customer spend of $1,400, and an average digital-only customer spend of $200." We have heard this same dynamic with many of our other retailers. Kevin Mansell, the CEO of Kohl's, recently stated that "regardless of whether they shop in the store or online, if you have a physical presence, you're top of mind. So having a physical presence is critical." This also explains the brick and mortar strategy that traditionally online-only retailers, such as Warby Parker, Bonobos and Amazon with their purchase of Whole Foods, have rolled out. In a study conducted in the U.K., retailers increased online traffic by 52% when opening a new store and this was even more impactful on brands with fewer stores, which saw an online increase of 84% when opening a new store.



*Estimated North American gross merchandise sales from quarterly filings.
**US gross merchandise value.
Source: L2 analysis of quarterly filings and US Census data.

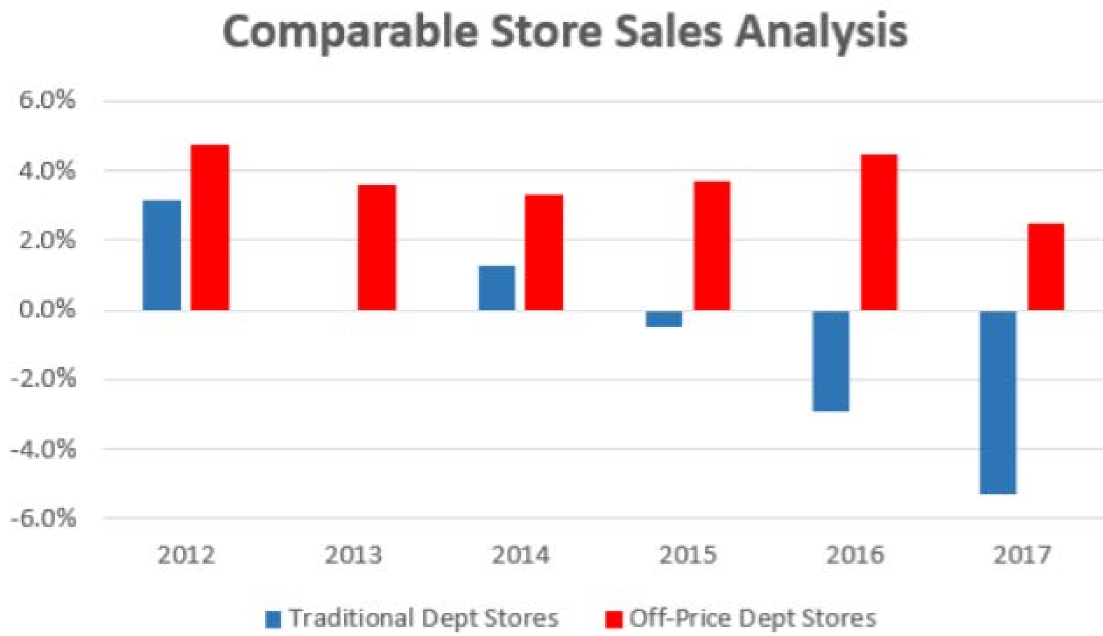
We saw the strength of brick and mortar particularly pronounced throughout this past holiday season, as several of our largest retailers performed exceptionally well and overall brick and mortar sales reportedly increased by 4.1%. The charts below show same store sales performance for many tenants, including several of ours, for the most recent holiday season and for the most recent two quarters.



Source: Company reports

Not only did these retailers see increased sales, but several of the largest that reported customer traffic, including Target, Kohl's, Walmart and TJ Maxx, have reported increased traffic. In fact, according to ICSC (International Council of Shopping Centers), during the holiday season 95% of customers purchased from retailers with a brick and mortar footprint and 90% of those who ordered online and chose to pick up in store bought more when picking up their merchandise. Furthermore, according to ICSC, more millennials visited a shopping center during the Thanksgiving/Black Friday weekend than any other age group.

As we have discussed in past letters, the negative fallout in the retail industry has been dominated by retailers that have been either troubled for several years (Sears, HH Gregg, etc) or overleveraged because of public-to-private transactions. In both cases, the current disruption in retail has magnified the operating issues and the over-leveraged companies have been unable to withstand sales and margin pressures. Those retailers that are overleveraged will not be able to withstand the reduced margins associated with maintaining a robust online platform (internet sales are not as profitable for online or brick and mortar retailers, therefore compressing margins). We have also seen a continued bifurcation between traditional enclosed mall retailers and those that dominate open air shopping centers. The chart below is one example, comparing traditional department store performance (those that typically occupy space in enclosed malls) and off-price department stores (those that typically occupy space in open air shopping centers.



Source: Creditntell

We have seen retailers focus on expanding their e-commerce presence and differentiating themselves in store. Two examples of this are Five Below and Best Buy. Five Below has seen success by giving its customers "extreme value and a fun customer experience", according to their CEO, and they ultimately see room to open more than 2,000 domestic stores. And Best Buy has been successful by creating an in-store electronics experience, giving customers the opportunity to play a videogame, try out different audio systems or work within one of the various store-within-a-store concepts (such as Apple or Microsoft).

We expect store closings to continue in 2018, particularly with poor operators, over-leveraged companies and mall retailers. Many of these retailers have been on our watch list for years. But we feel very good about the retailers within our portfolio and we firmly believe in our strategy of acquiring high quality, well located open-air shopping centers in smaller markets. Throughout 2017, we continued to see high levels of tenant renewals within our funds' portfolios (89% of tenants renewed) and renewal rent increases (10% average rent increase). We continue to believe that our portfolio is well positioned for stability and success. We look forward to investing alongside of you in our retail strategy and we welcome continued discussion of this environment.