

ATLANTA  
 AUSTIN  
 CHICAGO  
 CHICAGO DOWNTOWN  
 CINCINNATI  
 COLUMBUS  
 DALLAS  
 DENVER  
 DETROIT  
 ENCINO  
 FORT LAUDERDALE  
 HOUSTON  
 INDIANAPOLIS  
 LAS VEGAS  
 LONG BEACH  
 LOS ANGELES  
 MANHATTAN  
 MILWAUKEE  
 NEW HAVEN  
 NEW JERSEY  
 NEWPORT BEACH  
 ONTARIO  
 ORLANDO  
 PALO ALTO  
 PHILADELPHIA  
 PHOENIX  
 PORTLAND  
 SACRAMENTO  
 SALT LAKE CITY  
 SAN ANTONIO  
 SAN DIEGO  
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 WEST LOS ANGELES

## RETAIL TENANT OUTLOOK

### Retailers Shed Traditional Concepts to Gain Competitive Edge

*Single-tenant net-leased retail assets are a favorite of investors across the country due to their stable returns and easy to manage operations. Strong appreciation and solid fundamentals continue to support healthy buyer demand for single-tenant net-leased assets in 2005. Transaction velocity surged more than 30 percent in 2004 and is currently up 14 percent over one year ago. The median price of single-tenant properties is also increasing and is currently more than \$225 per square foot. Climbing prices have forced some investors, who once focused primarily on drugstore and fast-food restaurants, to seek other types of single-tenant assets. Despite slowing retail sales growth, major retailers are continuing to expand, thereby creating additional opportunities for investors in 2005.*

#### *Department Store Consolidation Changing Mall Landscapes*

Department stores have lost as much as one-third of their shoppers during the past decade to discounters such as Wal-Mart, Target and Kohl's. Consequently, many malls with department store anchors have had to tinker with tenant mixes and formats to attract shoppers and tenants. The mall format is coming under additional pressure as recent department store consolidation means a substantial amount of anchor space may become available over the next several years. The Sears-Kmart merger may push Sears to off-mall sites and may also lead to the conversion of Kmart stores to Sears. When the Federated-May merger is completed, Federated will focus on the 98 regional malls where the two companies overlap. Where the company owns its space, it will most likely add another Macy's brand store, such as Bloomingdale's, or sell the vacant box to another retailer. At locations where the company leases, however, the landlord may ultimately decide which retailer will occupy the space. The Saks chain announced in April the sale of its Proffitt's and McRae's chains to Belk. No store closures are expected, however, as Belk will assume leases. Finally, the recent sale of luxury icon Neiman Marcus has spawned speculation that the company will expand more aggressively.

#### *Drugstores Have Prescription for Success*

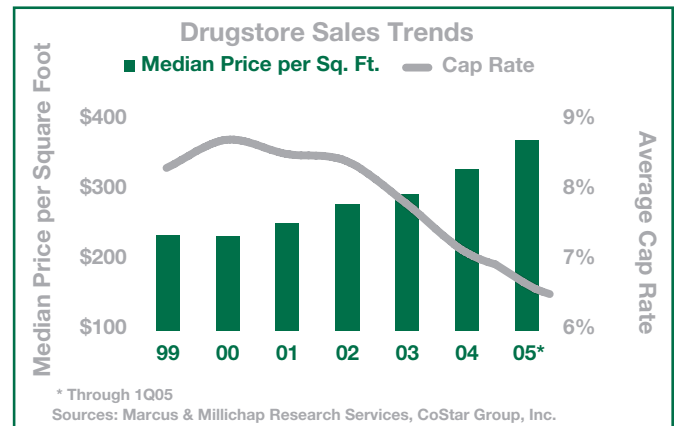
Drugstore chains posted record sales gains in 2004 and have continued to perform well to date in 2005. An aging baby boom population is supporting growth in the sector, a trend we expect will continue over the next several years. On the heels of the Eckerd acquisition in 2004, CVS is pushing forward with expansion plans while devising new strategies to improve its competitive position against Walgreens. CVS posted record sales in 2004 and a net earnings increase of 11.7 percent. The company plans to add 125 net new stores in 2005 and is on track to convert all Eckerd locations to its wider-aisle format by year end. Another major drugstore chain, Rite Aid, posted a 1.3 percent drop in revenue last year, citing business losses to mail-order pharmacies. Consequently, the chain recently announced plans to enter the benefit management business and offer competitively priced 90-day prescriptions. Walgreens continues to achieve double-digit sales growth, posting a second quarter fiscal 2005 gain of 12.8 percent. Gross profit margins were up 83 basis points versus the year-ago quarter to 28.5 percent. The retailer is on track to open a net 365 stores this year.

## Drugstores

### Limited For-Sale Inventory Keeps Prices Climbing

Investors seeking drugstore properties have had fewer properties from which to choose. As a result, transaction volume remains slow and is down 30 percent from one year ago. The median price over the past year surpassed \$319 per square foot, a 12 percent gain over the previous 12-month period. Based on sales reported to date in 2005, the median price for drugstore assets is closing

in on \$370 per square foot, with some properties in prime locations selling for more than \$700 per square foot. Cap rates have dropped below 7 percent nationally and are less than 6 percent in many parts of the country. Given the relative ease of managing a single-tenant property, investors often purchase assets outside of their home market. Only 39 percent of the drugstore properties sold over the past 12 months were purchased by investors living in the same state as the property is located, compared to more management-intensive strip centers, of which 75 percent of which were sold to investors residing in the same market. California buyers, however, are more likely than those in other states to stay close to home as 55 percent of California drugstore transactions over the past year that involved Golden State investors took place in the state.



## Fast Food

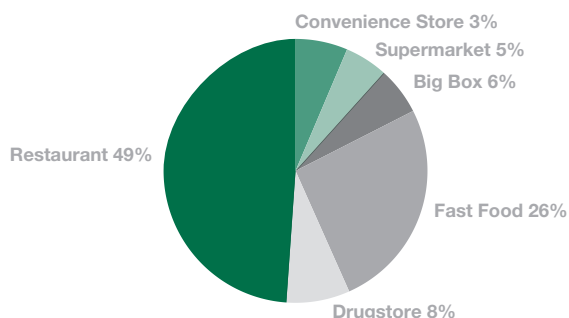
### Fast-Food Assets Selling at Healthy Pace

Despite heightened health consciousness among consumers, fast-food chains are thriving. Fast-food assets are popular among single-tenant investors, with demand supported by strong sales growth and aggressive expansion. Additionally, as most assets sell for less than \$2 million, less capital is required to purchase a fast-food restaurant, creating a larger buyer pool. Transaction volume jumped 35 percent over the past year while total dollar volume rose 45 percent. Increased demand resulted in a 15 percent increase in the median price over the past 12 months to \$410 per square foot, although assets in strong locations that are occupied by national tenants can

easily command twice that amount. Restaurants are adapting to fickle consumer eating habits by modifying menu choices and constantly introducing new products. McDonald's, for example, recently announced that it would begin offering higher-quality coffee in an attempt to compete with Starbucks, which now offers lunch items at 2,300 of its stores. Starbucks posted net revenue growth of 30 percent last year, reaching \$5.3 billion. Over the same period, McDonald's registered the highest comparable sales increase in 17 years, generating a record \$3.9 billion in cash from operations and leading Dow Jones Industrial components in share-price gain. It is no surprise that both chains are popular among investors, with freestanding Starbucks currently trading at a median price of \$455 per square foot and McDonald's selling for a median of almost \$420 per square foot. Co-branding, where two complementary tenants share one roof, is enticing diners and investors alike. By having two well-known brands under one roof,

co-branding increases store sales and increases profit margins. Investors are paying more for such assets. The median price for co-branded fast-food properties increased 30 percent over the last year to nearly \$475 per square foot.

**Single-Tenant Transactions**  
First Quarter 2004 to First Quarter 2005

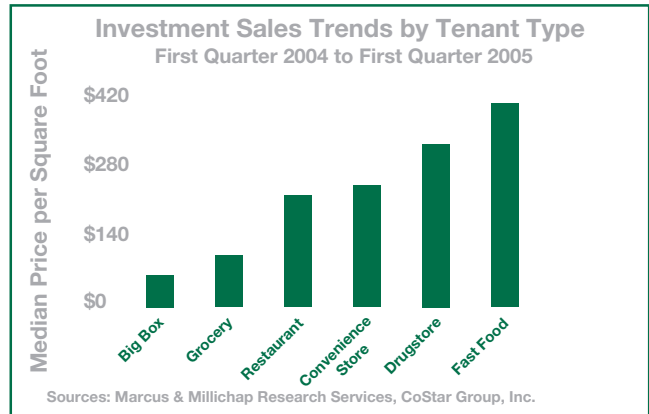


Sources: Marcus & Millichap Research Services, CoStar Group, Inc.

## Dollar Stores

### Dollar Stores Attracting Investor Capital

Buyers with limited capital who want to jump on the single-tenant band wagon are discovering dollar stores. Investor interest is bolstered by relatively low per-square foot prices and an average acquisition cost of \$665,000. Additionally, with deep discounters and fixed-price stores rapidly expanding, investment opportunities in the asset class are rising. Prices for dollar stores have remained relatively flat over the past year at around \$80 per square foot, but transaction and dollar volume have nearly doubled. Many investors find the property type challenging, as it often involves non-credit tenants on short leases.



The higher cap rates associated with these assets, which are currently in the 8 percent range, are enough to sway many buyers, however.

With a 12 percent increase in sales on a year-over-year basis and more than 5,600 stores in 44 states, Family Dollar is one of the strongest and fastest-growing deep-discount chains in the United States. The company expects to add 500 stores by year end and aims to increase the frequency of customer shopping trips and the average transaction size by offering perishables in many of its locations. The nation's largest deep-discounter, Dollar General, is also thriving and now has almost 7,500 stores. The chain plans to add 540 stores by year end.

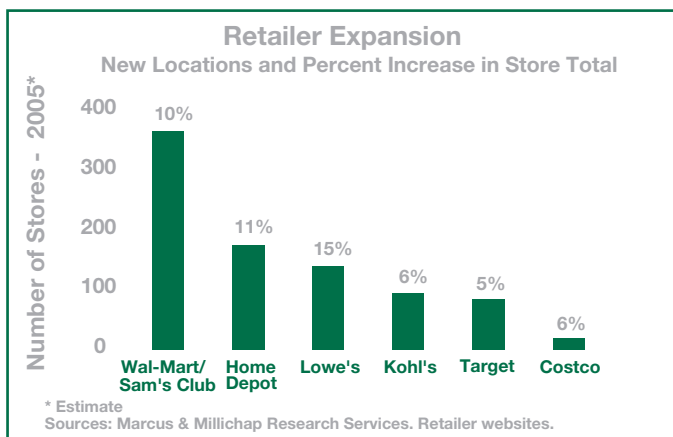
## Discount Stores

### The Politics of Big-Box Expansion

In communities across the United States, Wal-Mart is increasingly encountering opposition to new stores. Companies such as Kohl's and Target, however, have met less resistance. In increasing numbers, citizens are forming groups aimed at keeping big-box developments out of their neighborhoods. For example, in the Phoenix suburb of Chandler, local residents rallied against three different proposed Wal-Mart sites, and the city council denied approval for the projects. Legislatures are also

getting involved, passing so-called "Wal-Mart bills" aimed at large retailers in the hopes of saving mom-and-pop businesses and discouraging supercenter development. In Philadelphia, the city council is attempting to pass a measure that would prohibit building stores measuring in excess of 180,000 square feet and would place significant restrictions on those over 90,000 square feet. In Maryland, a bill forcing large companies to cover health care costs or face an additional tax is working its way through the state legislature. To combat such actions, Wal-Mart is trying to improve its public image by positioning itself as a community partner. For example, the retailer has created a land conservation partnership with the National Fish and Wildlife Foundation, pledging \$35 million over the next decade to protect one acre of wildlife habitat for each acre it develops. Additionally, Wal-Mart has created a website that aims to combat negative perceptions and myths about the company by

focusing on its positive contributions to communities. The retailer has also launched a nationwide ad campaign to "set the record straight" on the company's wage and benefit policies.



# Marcus & Millichap

## NATIONAL RETAIL GROUP

Marcus & Millichap's National Retail Group (NRG) is the only national investment resource dedicated to providing retail owners and investors with advisory, financing and transaction services. The group is comprised of 270 specialists with unparalleled knowledge, access to qualified buyers and transaction expertise for all types of retail properties.

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## Grocery Stores

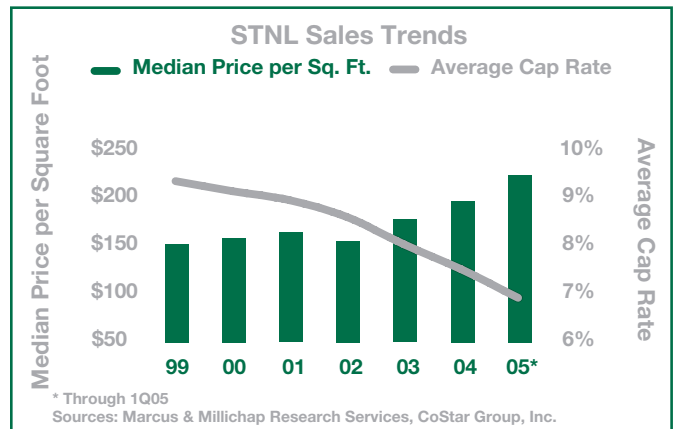
### Thinking Outside the Cart Key to Maintaining Market Share

Investors remain confident about grocery-store investments despite the inroads Wal-Mart is making into the market. Over the past 12 months, grocery store dollar volume rose almost 30 percent, while the median price per square foot jumped 27 percent to approximately \$104. Wal-Mart continues to gain market share in many markets, which has led some traditional grocers to implement alternative strategies to set themselves apart. Safeway recently announced that it would begin a new advertising campaign to promote its stores as an upscale alternative to Wal-Mart. Additionally, the chain will be converting its Dominick's brand to the successful "lifestyle" format it developed in California, which features higher-end goods. Whole Foods has found success with its natural and organic foods concept, producing \$3.9 billion in annual revenue and landing the company a spot in the Fortune 500. Kroger recently introduced a new online service that allows its customers to order everything from caviar to organic foods over the Internet. Regional grocers are also realizing success, not necessarily by carving out niches, but by cultivating customer loyalty in their base markets. Texas-based HEB, for example, has continued to thrive in a state with over 320 Wal-Marts by focusing on local patriotism. The 114-store Bashas' chain has established its place in Arizona by marketing itself as the hometown grocer. Wisconsin's Piggly Wiggly chain has adopted the "if you can't beat them, join them" strategy by discounting prices.

## Home Improvement

### Home Depot Adapts as Lowe's Grows

Sales of home improvement centers fell 60 percent last year. A dearth of for-sale properties stymied volume, and investors became concerned about the effects that rising interest rates and an ensuing slowdown in cash-out home financing will have on spending. Over the past 12 months, assets in rural locations accounted for a significant portion of sales activity, resulting in a 20 percent drop in the median price to \$75 per square foot. Properties in rural locations typically sell at lower price points. Home improvement retailers, however, continue to post strong sales growth as the national homeownership rate has reached a record 69 percent. Home Depot, the nation's second-largest retailer, posted increased revenues of 13 percent last year while the Atlanta-based chain's net income climbed almost 16 percent. Same-store sales rose 5.4 percent during the same period. Building on the growing demand for its "do-it-for-me" services, the company's services business grew 27.9 percent during fiscal 2004. Home Depot registered a record average ticket of \$54.89 in fiscal 2004, representing an increase of 7.3 percent from one year earlier. The chain plans to add 175 stores by year end. Lowe's continues to implement its urban growth strategy to compete with its much larger rival. Lowe's revenue last year jumped 18.2 percent to \$36.5 billion, with comparable-store sales climbing 6.6 percent. Privately held Wisconsin-based Menards has plans to add 20 superstores to its 186-store chain in 2005. The company has a solid reputation and a loyal customer base in the Midwest due to its low-priced quality merchandise and excellent customer service.



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