# RetailResearch

SINGLE-TENANT OUTLOOK

Marcus & Millichap

*Second Half 2008*

## Single-Tenant Investors Targeting Top-Tier Assets

The outlook for single-tenant retail properties should improve through the rest of 2008, as the economy is expected to gain some momentum in the second half. During the second quarter, however, the University of Michigan consumer sentiment index reached a 26-year low, as employment losses, record-high energy prices and tighter lending standards are suppressing consumer confidence and spending. Department stores, furniture outlets and apparel retailers are already feeling the effects of more modest spending, and while the government's economic stimulus package may help somewhat, growth in same-store retail sales is expected to remain limited. Better-performing asset classes will be those that sell necessities at bargain prices. Wholesalers, discount retailers and drugstores should weather the downturn best. Higher fuel costs are allowing big-box stores with gas stations, such as Wal-Mart, Sam's Club and Costco, to capture market share from traditional gas stations, where prices are typically higher.

The investment outlook for single-tenant properties is expected to be mixed throughout the rest of the year, with buyers becoming increasingly selective. The impact of slower economic growth, tighter underwriting and fewer apartment owners crossing over into single-tenant retail properties is causing a slowdown in sales velocity, trends that are expected to continue during the next few quarters. The uncertain climate is resulting in investors pursuing safe choices, with buyers typically targeting national-credit tenants in primary markets. As such, well-located, necessity-based retail properties such as drugstores and gas stations have continued to change hands while other assets are receiving few offers. Cap rates have edged higher, but the deep discounting that some opportunistic buyers have been hoping for are not expected to materialize this year.

## Single-Tenant Retail Market Overview

7.0% Cap Rate
Up 30
Basis Points
1Q07 - 1Q08

**Quick Service Restaurants:** McDonald's will install coffee bars at all of its U.S. locations over the next two years, a move that is the biggest addition to the company's menu in 30 years.

6.9% Cap Rate
Up 20
Basis Points
1Q06 - 1Q07

**Discounters/Big-Box:** Costco reported a 7 percent gain in U.S. same-store sales growth for the four weeks ending on May 4, 2008, compared to the same period a year earlier. The increase in sales was spurred by a 17 percent spike in gasoline prices.

7.0% Cap Rate
Up 10
Basis Points
1Q07 - 1Q08

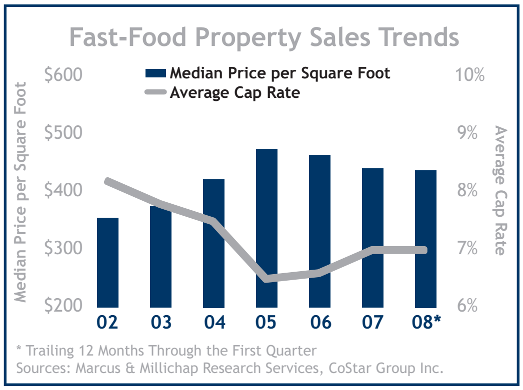
**Casual Dining:** Year-over-year sales at Chipotle rose 37 percent in the first quarter of 2008, due partially to new store openings. The company opened 28 new restaurants during the first quarter and had comparable sales growth of 10.2 percent. Revenue for the first quarter of 2008 increased 29.3 percent to $305.3 million from $236.1 million one year earlier.

6.7% Cap Rate
Up 10
Basis Points
1Q07 - 1Q08

**Drugstores:** Major drugstores such as Walgreens and CVS continue to attract buyers, but they are facing greater competition from discounters. Wal-Mart's $4 generic prescription drug program has been effective in capturing market share from drugstores.

7.3% Cap Rate
Up 80
Basis Points
1Q07 - 1Q08

**Grocery Stores:** Sales velocity for grocery stores has fallen by nearly 20 percent over the last 12 months; however, supermarkets may be one of the few segments to register any strength in sales going forward as consumers change their spending habits and decide to prepare more meals at home.

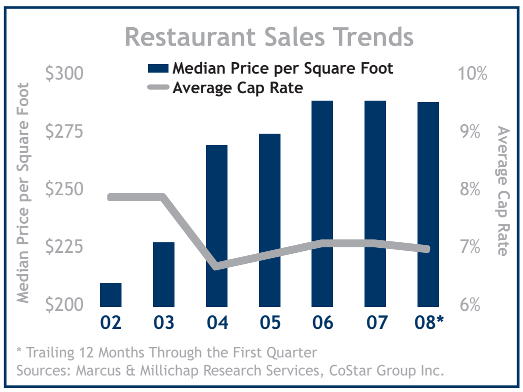



## Quick Service Restaurants

*Innovation and Mergers Driving Growth*

In an effort to weather the recent slowdown in consumer spending, fast-food franchises are turning to innovation and mergers to ignite future sales growth. McDonald's, which experienced its first same-store sales decline in five years last March, plans to install coffee bars at all of its U.S. locations within the next two years. It is the biggest addition to the company's menu in 30 years, with forecasts calling for $1 billion in annual sales. In an effort to capture greater market share, Wendy's International Inc. will be acquired by Arby's parent, Triarc, in a stock deal valued at about $2.3 billion, excluding debt. When completed, Wendy's and Arby's will combine to form the third-largest fast-food company in the world.

The investment outlook for quick-service restaurant properties remains healthy, despite fewer properties changing hands. Sales velocity has declined by 9 percent over the last 12 months, due in large part to fewer investors allocating 1031-exchange proceeds from apartment sales into fast-food properties. With fewer buyers in the market, the median price has dropped 3.7 percent to $439 per square foot year over year, and cap rates have climbed 30 basis points to 7 percent during that time.

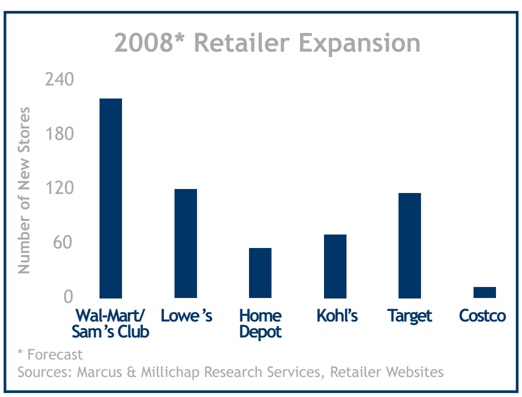



## Casual Dining Restaurants

*Consumers Still Spending at Casual Dining Restaurants*

Casual dining restaurants have continued to record solid performance in the past few months. IHOP's acquisition of Applebee's produced the company's first quarter of positive same-store sales growth since the beginning of 2006. While systemwide same-store sales at IHOP rose 3.7 percent in the first quarter of 2008, Applebee's systemwide domestic same-store sales increased 0.5 percent. Consumer spending also remained strong at Brinker International restaurants Chili's and Romano's Macaroni Grill. Through the first quarter of 2008, these restaurants have reported that business is either equal to or greater than last year.

Buyers continue to actively pursue casual dining restaurant properties, with current transaction velocity maintaining the pace recorded over the previous 12 months. Cap rates have averaged around 7 percent in that time, while the median sales price has ticked up to $288 per square foot. Investors should be cautious, however, as even the major chains have begun closing properties that do not perform well, and many are also scaling back expansion plans.




## Discount Stores

*Some Discounters Still Expanding*

The economic slowdown is forcing some major discount retailers to curtail the building of new stores. Wal-Mart plans to completely phase out new construction of its conventional outlets by fiscal 2009 in favor of its grocery/discount-goods Supercenter format. Development of all new Wal-Mart outlets, Sam's Club stores and Neighborhood Supermarkets will eventually be cut to 220 sites by fiscal 2010, down from the 340 locations that were opened in 2007. Other discounters, however, are continuing to expand; new store openings at Target and Costco in 2008 should closely mirror last year's pace.

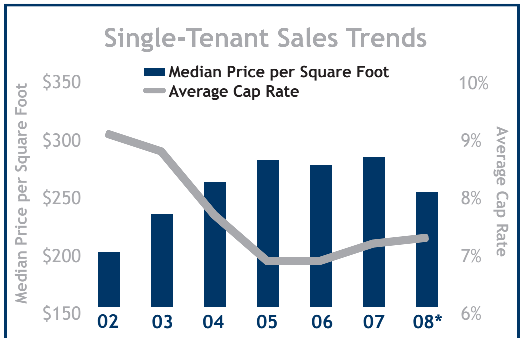
Sales velocity for discounters has remained fairly steady in recent months, although there is a wide disparity in pricing and cap rates depending on tenant quality. Smaller discounters such as Family Dollar and Dollar General continue to trade with cap rates ranging from 7.5 percent to 8.0 percent, while larger stores, including Wal-Mart, Sam's Club and 99 Cents Only, are changing hands with cap rates between 5.8 percent and 6.5 percent. This trend is expected to continue as buyers remain focused on top-tier assets.

## Home Improvement/Furnishings

*Linens 'n Things Files for Bankruptcy Protection*

Home improvement and furnishing stores, which had excelled during the housing boom, are now being hardest hit as the market sags. With an increasing debt load, a slowing economy and a disparaging housing market, home furnishings retailer Linens 'n Things is filing for Chapter 11 bankruptcy protection and closing 120 of its 589 stores. More than one-third of the affected stores will be located in California, Texas and Michigan. Home Depot is abandoning plans to add about 50 U.S. stores to save cash for existing locations. Additionally, the company will close 15 U.S. sites that are not performing up to the company's expectations. If the housing market starts to rebound in the second half, home improvement stores could begin to record some gains over the next few months.

The investment market for home improvement/furnishings stores remains limited by the amount of available inventory. The few properties that have traded over the past year have exchanged at cap rates in the high-5 percent to high-6 percent range. As major companies close stores, however, investment properties that are either anchored by or are ancillary to these shuttered assets could be negatively affected.



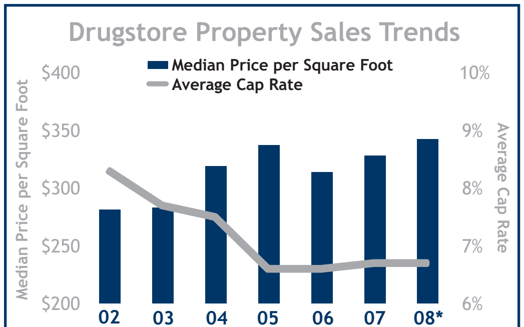
* Trailing 12 Months Through the First Quarter
Sources: Marcus & Millichap Research Services, CoStar Group Inc.

## Drugstores

*Buyers Attracted to Drugstores, Fewer Properties Being Listed*

Despite some concerns that drugstore industry sales would remain weak after a soft holiday season in 2007, CVS Caremark Corp. posted strong earnings in the first quarter, as the addition of Caremark's pharmacy benefits business helped to offset the impact of lower-priced generic drugs. In an ongoing effort to diversify sales, Walgreens recently purchased I-trax Inc. and Whole Health Management of Cleveland, which provides urgent care, wellness programs and other services.

Year over year, sales velocity for drugstores has declined by 17 percent, mainly due to a lack of for-sale inventory. Nevertheless, investors are still coveting these assets, as evidenced by cap rates remaining in the mid-6 percent range over the past 12 months and the median sales price increasing 13.2 percent to $342 per square foot. The combination of tighter lending criteria and buyers demanding higher yields could, however, further decelerate sales velocity during the next year.



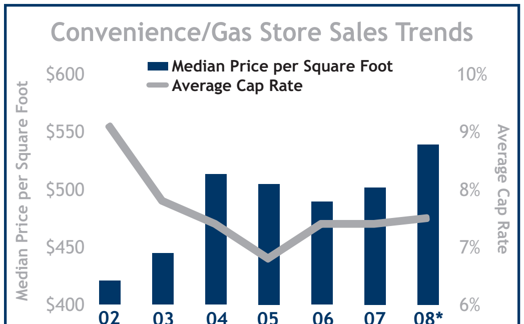
* Trailing 12 Months Through the First Quarter
Sources: Marcus & Millichap Research Services, CoStar Group Inc.

## Convenience Stores/Gas Stations

*Operators Under Close Observation as Oil Prices Surge Higher*

With gas prices approaching $4 per gallon, convenience stores and gas station properties will be under greater scrutiny from investors. Traditionally, operators of these businesses have been slow to pass along higher gas prices to the public for fear of driving away customers. Business owners will want to pay particular attention to the rapid changes in fuel prices that have been occurring in recent months. In the current climate, thousands of dollars can be left in the underground storage tanks if operators focus solely on volume and are lax about margins.

While single-tenant sales velocity has slowed in recent quarters, convenience stores and gas stations continue to attract buyers. Over the last 12 months, velocity has ticked up by 1 percent, as buyers have been attracted to cap rates in the mid-7 percent range. The increased buying activity, along with more properties changing hands in primary markets, has driven the median sales price for assets in this segment nearly 12 percent higher to $539 per square foot over the past year.



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## Grocery Stores

*Grocers Looking to Attract Economic Stimulus Dollars*

Competition remains fierce in the grocery business and companies are taking steps to bring additional customers into their stores. In response to the U.S. government's economic stimulus plan, Kroger announced that it will allow customers to receive free groceries by exchanging their tax refund checks for Kroger gift cards with an added $30, $60 or $120 on the card. Wal-Mart is also using the stimulus package to obtain more foot traffic by allowing customers to cash their refund checks in stores at no charge and with no purchase necessary. The company will also introduce a number of price rollbacks on grocery and consumable items this year while expanding some of its Orange County stores by as much as 50,000 square feet to add produce, bakery goods and fresh-cut meats.

Grocers have been paying close attention to British-based Tesco's expansion plans. At the end of the first quarter, the company announced that it was going to halt the expansion of its U.S. Fresh & Easy Neighborhood Market operations in order to evaluate its progress. Recently, however, the company has become more optimistic, as it is now planning to open 150 more Fresh & Easy stores in the nation this year. The competition in the grocery industry has resulted in a 20 percent decline in sales velocity over the last 12 months, while the median sales price has fallen 12 percent to $128 per square foot. Nevertheless, supermarkets may be one of the few segments to display any sales strength going forward, as they can pass on extra costs to customers while benefiting from shoppers opting to prepare more meals at home. This trend should help to attract investors who chose to sit on the sidelines in the first half of 2008 and increase sales velocity through the end of the year.

## Recent Single-Tenant Sales Highlights

| Property Name | City, State | Sales Price | Cap Rate | Price/ Sq. Ft. |
|---|---|---|---|---|
| Rite Aid | Carlsbad, CA | $6,150,000 | 5.1% | $283 |
| Walgreens | Gardnerville, NV | $6,050,000 | 6.0% | $408 |
| Romano's Macaroni Grill | Dublin, CA | $5,930,000 | 6.5% | $790 |
| Just Tires | Glendale, CA | $5,700,000 | 6.2% | $365 |
| Walgreens | Forney, TX | $5,350,000 | 6.2% | $361 |
| La-Z-Boy | Lansing, MI | $5,200,000 | 7.2% | $176 |
| Kerr Drug | Hillsborough, NC | $5,090,276 | 7.3% | $407 |
| Office Depot | Canon City, CO | $4,300,000 | 6.6% | $208 |
| Fresh & Easy Neighborhood Market | Mesa, AZ | $3,892,000 | 6.5% | $259 |
| Colonial Bank | Oxford, AL | $3,837,620 | 6.7% | $424 |
| Chuy's | Surprise, AZ | $3,725,000 | 7.0% | $593 |
| Applebee's | Auburn, CA | $3,150,000 | 6.4% | $606 |

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