RetailResearch

MARKET OVERVIEW

Marcus & Millichap

Chicago Metro Area *Second Quarter 2013*

Investor Demand for Retail Assets Rises; Cap Rates Tighten

Chicago's retail market will improve further in 2013 as healthy job creation supports another year of strong consumer spending. Metrowide, build-to-suit projects and pre-leased shopping centers dominate the development pipeline, which will drive a sizable share of new demand into existing shopping centers. In-city centers stand to post the most improvement this year as payrolls in the typically higher-paying professional and business services sector return to their previous peak level, and the delivery of more than 3,300 luxury apartments lures affluent renters to the area. The anticipated influx of new residents to the city has prompted expansion among grocers. Mariano's recently signed on to anchor a new retail center in Oak Lawn and Wal-Mart is under way on a Neighborhood Market at 47th Street and Cottage Grove. While the suburbs have lagged in the recovery cycle, vacancies in well-located centers have started to capture the interest of expanding retailers, particularly chains specializing in home-related goods.

Investor demand for Chicago retail properties will remain elevated this year as job creation continues at a healthy pace and recovery in the housing market strengthens. Transaction velocity, however, will hold fairly stable as better-quality listings remain in short supply. The lack of for-sale inventory will be most pronounced in the single-tenant sector, where reduced retailer expansion through the downturn led to a sizable reduction in deliveries. As a result, cap rates for newer high-credit deals will hold near historically low levels. The most sought-after single-tenant assets, such as corporate-owned McDonald's, start in the low- to mid-4 percent range, while Chase Bank properties trade sub-5 percent and newer Walgreens sell between 5.75 and 6.0 percent, but have dipped to around 5.5 percent for top locations. Over the past year, cap rate compression has prompted many traditionally single-tenant investors to pursue small strip centers occupied by high-credit tenants. Such properties change hands at cap rates between 6.25 and 7.75 percent, with in-city assets falling at the low end of the range. The search for higher yields has also sparked demand for better-quality retail properties in expansion markets, including parts of Kane, Will and Lake counties.

2013 Annual Retail Forecast

1.4% increase in total employment

Employment: Metrowide employment will rise 1.4 percent in 2013 with the addition of 63,200 new jobs, supporting another year of growth in local retail spending. In 2012, payrolls in Chicago increased 1.7 percent.

647,000 square feet will be completed

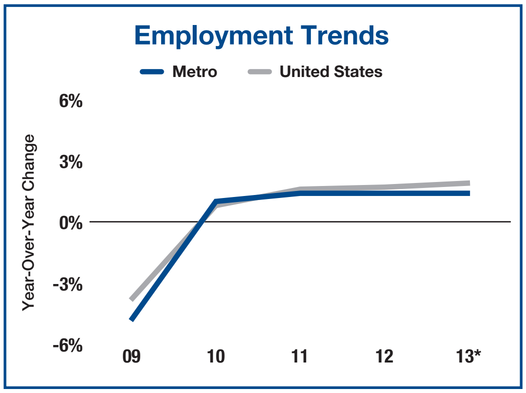
Construction: Metrowide deliveries of new strip, neighborhood and community centers will total approximately 647,000 square feet, up from 390,000 square feet in 2012. The majority of shopping center space slated for completion is pre-leased.

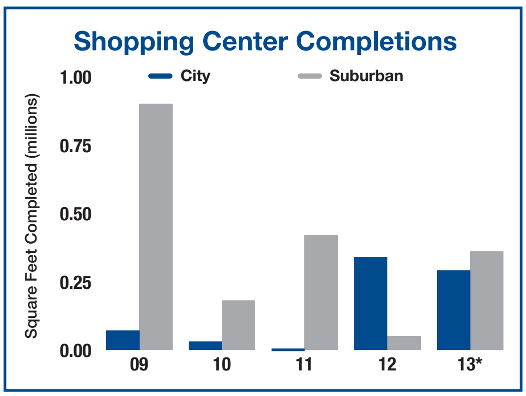
50 basis point decrease in vacancy

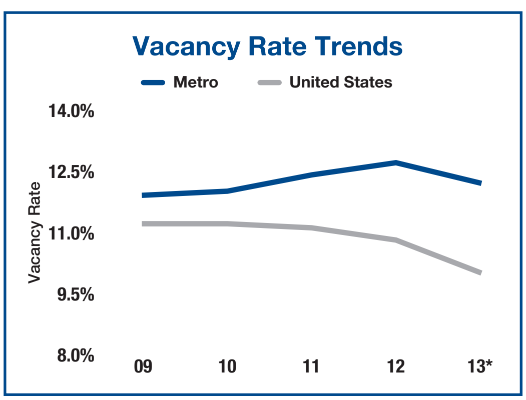
Vacancy: Throughout the Chicago metro, vacancy rates for neighborhood, community and strip center properties will slip 50 basis points in 2013 to 12.2 percent. During 2012, vacancy rose 30 basis points.

0.4% increase in asking rents

Rents: Market rents for available shopping center space are likely to end the year at approximately $14.40 per square foot, up 0.4 percent from one year earlier. In 2012, the average asking rent slipped 3.4 percent as better-quality space was removed from the equation due to absorption.







* Forecast

Sources: CoStar Group, Inc.

Vacancy, rent and construction data throughout this report measures neighborhood/community centers unless otherwise noted.

Economy

- Over the 12-month period ending in March, employment in the Chicago metro increased 0.9 percent with the addition of 41,200 jobs. Payrolls grew 1.7 percent in the corresponding period last year.
- The education and health services, and professional and business services sectors accounted for the most job creation over the past 12 months; each added more than 14,000 positions. Expansion in these typically better-paying sectors helped drive a nearly 5 percent increase in retail sales over the same time period.
- Chicago's retail trade sector lost 5,000 jobs over the past year, due partly to major chains including Kmart, Kroger and Best Buy closing underperforming stores. Some large retailers have also been shifting away from big-boxes to smaller-scale concepts, which has likely affected payrolls in the industry.
- A modest recovery in single-family housing construction is under way in the Chicago metro. Homebuilders completed 5,300 single-family homes over the past year, a 25 percent rise from the prior 12 months. While construction is well below pre-recession norms, new subdivisions nonetheless generate additional traffic at local shopping centers.
- **Outlook:** Metrowide employment will rise 1.4 percent in 2013 with the addition of 63,200 jobs, supporting another year of retail spending growth. In 2012, payrolls increased 1.7 percent.

Construction

City

- No community, neighborhood or strip centers were delivered in the city during the first quarter. At the end of the period, projects totaling 290,000 square feet were under way.
- In addition to shopping center development, several single-tenant projects are under construction in Chicago. Target, Wal-Mart, Mariano's Fresh market and Walgreens, along with various fast-food and specialty retailers, will open stores in the city this year.
- **Outlook:** Neighborhood, community and strip center completions in the city will total 290,000 square feet in 2013. Last year, in-city shopping center deliveries totaled around 343,000 square feet.

Suburban

- Over the past 12 months, developers completed 234,000 square feet of neighborhood, community and strip center space, down from 326,000 square feet in the corresponding period last year. An additional 157,000 square feet is under way.
- As of first quarter, more than 1.9 million square feet of single-tenant retail space was under construction in the suburbs. The total includes multiple Mariano's Fresh Market locations, in addition to a handful of big-box home improvement and auto parts stores. In Romeoville, a new Sam's Club, adjacent to an existing Wal-Mart Supercenter, is also under way.
- **Outlook:** In the suburbs, new neighborhood, community and strip center construction will total 357,000 square feet in 2013, up from approximately 47,000 square feet last year.

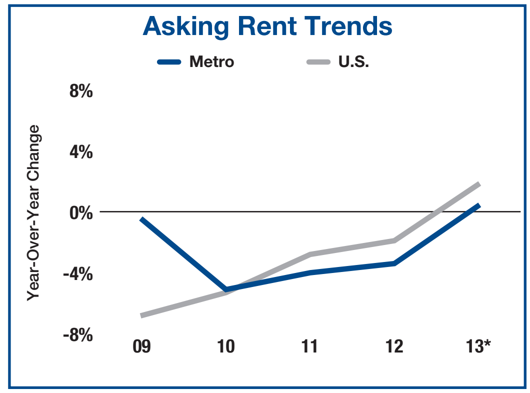
Vacancy and Rents

City

- Vacancy rates among neighborhood, community and strip centers in the city declined 30 basis points over the past 12 months to 8.6 percent. During the corresponding period last year, vacancy increased 160 basis points.

- Rents for available shopping center space in Chicago averaged $18.43 per square foot in the first quarter, up 2.5 percent from the same period in 2012.

- **Outlook:** In-city vacancy should slip in the near term as new supply comes to market largely pre-leased, driving tenants into existing properties. Owners will continue to regain pricing power as conditions tighten.

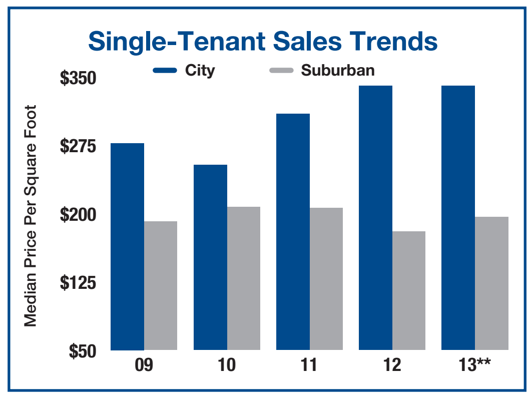


Suburban

- Suburban shopping center vacancy dipped 10 basis points over the past 12 months to 12.9 percent. During the corresponding period last year, the vacancy rate increased 40 basis points.

- In the first quarter, the average rent for available neighborhood, community and strip center space hovered around $13.77 per square foot. One year earlier, the average for marketed space was $14.32 per square foot.

- **Outlook:** With limited shopping center construction under way in the suburbs of Chicago, many retailers will target well-located existing properties for expansion. As a result, vacancy should decline moderately.



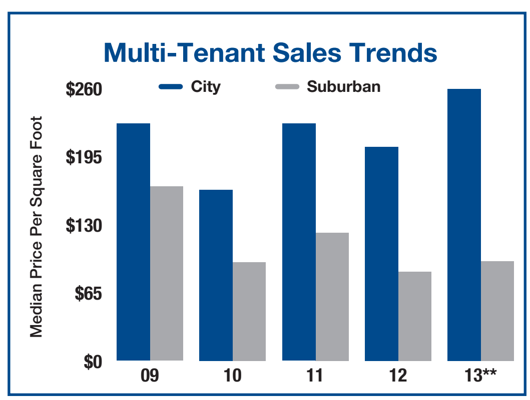
Sales Trends**

City

- In-city multi-tenant retail sales accelerated over the past 12 months. While the median price over that period was just shy of $260 per square foot, a few prime storefront deals closed upwards of $500 per square foot.

- Newer Walgreens sell at cap rates in the 5.75 to 6.0 percent range, but have slipped lower for top locations. Assets with 10 years or less of lease term remaining, on the other hand, often sell at cap rates 150 to 250 basis points higher.

- **Outlook:** Low interest rates and a shortage of better-quality listings, relative to demand, will keep cap rates for high-credit in-city deals at historically low levels.



Suburban

- Cap rates for suburban shopping center properties traded over the past year ranged from approximately 7 to 10 percent, depending on location, asset quality and tenant-credit.

- Single-tenant sales in the suburbs decelerated amid a shortage of for-sale inventory. The majority of deals involved fast-food and restaurant properties, which changed hands at median prices of $285 and $184 per square foot, respectively.

- **Outlook:** Historically low cap rates for single-tenant deals will drive more investors into the market for smaller, high-credit strip centers. Depending on location, such properties change hands between 6.25 and 7.75 percent.

* Forecast
** Trailing 12-Month Period
Sources: CoStar Group, Inc., Real Capital Analytics

Vacancy, rent and construction data throughout this report measures neighborhood/community centers unless otherwise noted.

Capital Markets

By WILLIAM E. HUGHES, Senior Vice President, Marcus & Millichap Capital Corporation

- Amid evidence that an increase in payroll taxes was crimping retail sales, shopping center vacancy nationwide nonetheless dipped 10 basis points in the first quarter of the year to 10.7 percent. Despite the prospect of subdued consumer spending over the remainder of 2013, space demand will far exceed completions during the year, supporting an 80-basis point plunge in vacancy to 10.0 percent.

- The improvement in property operations, a more competitive lending environment and favorable returns relative to other asset classes are sustaining a healthy investment market. One-off transactions totaled more than $6 billion in the first quarter this year, marking an increase of 9 percent from one year ago. Investors also purchased $4.2 billion of strip centers in the first three months of 2013, a 20 percent year-over-year jump.

- Leverage levels were virtually unchanged during the first three months of this year. Acquisition loans for multi-tenant assets and single-tenant net-leased properties are typically underwritten at 65 percent LTV, but can range up to 70 percent for the highest rated assets in the strongest locations, and quality sponsorships.

- For single-tenant, net-leased assets, most capital sources are willing to consider properties occupied by non-investment grade tenants, although top-rated tenants remain the primary target. Conduits and life companies focus on upper-tier assets and the highest-rated tenants, while commercial banks and credit unions vie for market share in the arena of lower-rated corporate and franchisee credits. Loans are underwritten for 10-year terms, 25-year amortization, at rates ranging from 4 percent to 5 percent.

- Securitized lenders and life companies continue to provide financing for purchases of anchored shopping centers, while commercial banks are lending on unanchored properties. For unanchored assets, loans are generally executed for three- and five-year terms and all-in rates ranging from 4.25 percent to 4.75 percent.

Local Highlights

- Construction payrolls remain at a deficit when compared with year-ago levels, but the early 2013 performance suggests the onset of recovery in the sector. During the first quarter, construction-related employment grew by 5,250 positions, outpacing job creation in all other major sectors

- The number of existing single-family homes sold in the metro jumped 25 percent year over year, while the median price held at $175,100. The current median price is nearly 40 percent less than the median price at the market's peak.

- Officials in Glenview recently approved the creation of a tax increment financing district that will be anchored by a 75,000-square foot Mariano's Fresh Market. The site will also hold a bank, more than 200 apartments, and an additional 30,000 square feet of retail space. Construction will start in 2014.

- Construction crews commenced work on a $250 million mixed-use development in Arlington Heights during the first quarter. The project's initial phase consists of a 214-unit apartment building with ground floor retail. Necessity-based retailers are envisioned as part of future phases.

- The Orland Plaza shopping center in Orland Park is being razed. Local officials view the site as an integral part of plans to redevelop the city's Main Street Triangle and are actively marketing it to developers.

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