RETAIL SALES & THE ECONOMY

February 2008

Walter Page
Managing Director, Research and Strategy
American Realty Advisors

Rose McGuire
Manager, Market Analysis

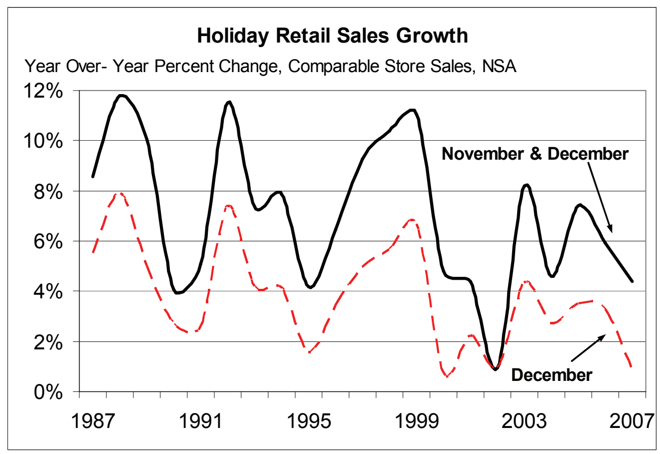
In this month's newsletter, we will discuss the 2007 holiday retail sales report and its impact on the retail sector. We will also highlight our target market strategy for the retail sector.

Over the past few years, the consumer has been the driving force of US economic growth, with consumer spending pulling the nation out of the 2001 recession. Now, with weakness in the housing market, higher energy prices, tightening credit conditions and general market uncertainty, consumer-led economic growth has slowed considerably.

To measure consumer spending, most analysts look to the holiday retail season – the time between the day after Thanksgiving and Christmas – as sales in this period comprise between 25% and 40% of annual sales and up to 75% of annual profit.

Going into the holidays, retailers were already aware of changing market conditions and had lowered expectations. As shown in the chart to the right, December only year-over-year sales growth at chain stores open at least one year remained roughly flat at 0.9%, well below the December average growth rate of 3.8%. In fact, this was the worst December since 2000, when sales grew by only 0.7%.

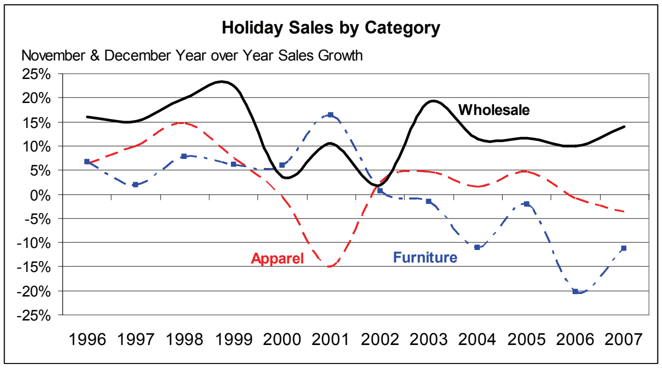
One contributing factor to poor December results may have been the earlier arrival of Thanksgiving this year, shifting more holiday shopping days to November from December. Removing the calendar effect by combining November and December sales, the 2007 holiday season was still weak, with combined year-over-year sales growth of 4.4%, well below the historical average of 7.1%. While retail sales have clearly slowed, they are showing 3.4% more growth than the recession year of 2002, when November and December sales growth was only 1.0%.



Source: Economy.com

Retail by Category & Retailer

Retail Categories: Examining December only sales figures, all retail categories suffered, with department stores and specialty apparel faring the worst. Year-over-year department store sales declined 7%, while apparel sales declined 4.4%. Although drug stores and wholesale clubs fared better, with sales growth of 2.2% and 5.3% respectively, these results were still well below their long-term December averages around 7%. However, by combining November and December sales figures, department stores registered sales growth of 1.5%, slightly above their 1.4% 10-year average. On the other hand, drug stores registered only 5.5% cumulative sales growth, nearly three times below the 15.4% average for the category, due to a mild flu season and a large number of generic drugs entering the market. Indicating the slowing housing market's impact on retail, furniture sales registered an 11.3% decline in sales this holiday season versus its average holiday sales growth of 0.4%.



Retail Sales Growth by Category	Apparel	Department	Drug	Furniture	Wholesale
November & December, 2007	-3.6%	1.5%	5.5%	-11.3%	13.9%
Nov. & Dec., 10-Year Historical Average	2.9%	1.4%	15.4%	0.4%	12.6%

Source: Economy.com

Of note, internet sales growth also was not immune to the effects of slowing consumer spending, registering only 18.5% growth for the November through December holiday period, down significantly from the 25% growth for this period seen in previous years. 2007 posted the lowest holiday internet sales growth rate since at least 2003.

Retailers: Concerned about weaker sales, some retailers advertised discounts well before the season began, while some even ran sales events several weeks before Black Friday. Consumers wanted deals this season, and those retailers offering the deepest discounts fared the best.

GameStop was a stand-out retailer this holiday season, with 20% comparable store sales growth versus expected growth of around 15%. This was due in part to the sales of next-generation gaming consoles, such as the Nintendo® Wii and the PS3™. Circuit City sales fell 11.4%, impacted by reductions in store staffing. Finally, Costco achieved 7% sales growth for December, boosted by higher gasoline prices at US locations and a weak dollar at international locations.

December Sales Growth Year-Over-Year Sales Growth for Comparable Stores			
Warehouse Clubs		**Discounters**	
Sam's Club	3.4%	Target	0.6%
Costco	7.0%	Wal-Mart	2.7%
BJs	3.0%	TJX	3.0%
Department Stores		**Apparel**	
Macy's	-7.9%	Ann Taylor	-9.4%
Kohls	-11.4%	Chico's	-13.7%
Nordstrom	-4.0%	The Buckle	18.7%
Drug Stores		**Electronics**	
Walgreens	2.6%	Best Buy	1.5%
CVS	1.8%	Circuit City	-11.4%
Rite Aid	-0.5%	GameStop	20.0%

Source: Economy.com

One unknown factor for sales this year could be gift cards. Reports suggest gift cards were very popular this season, and since these cards do not hit a store's bottom line until they are used, a surge in sales in the first quarter of 2008 could result from increased gift card spending. Some retailers, like Wal-Mart and Sears, even advertised to consumers to use their gift cards in January.

Grocery Outlook

The same factors affecting retail sales – the housing slowdown, higher energy prices, tighter credit conditions and general market uncertainty – are also affecting the grocery category. However, as grocery is a necessity-retail category, grocery sales growth has been somewhat shielded from the declines that have appeared in other retail categories. In fact, grocery sales growth usually benefits in an uncertain or slowing economy, as the consumer economizes by cooking more meals at home.

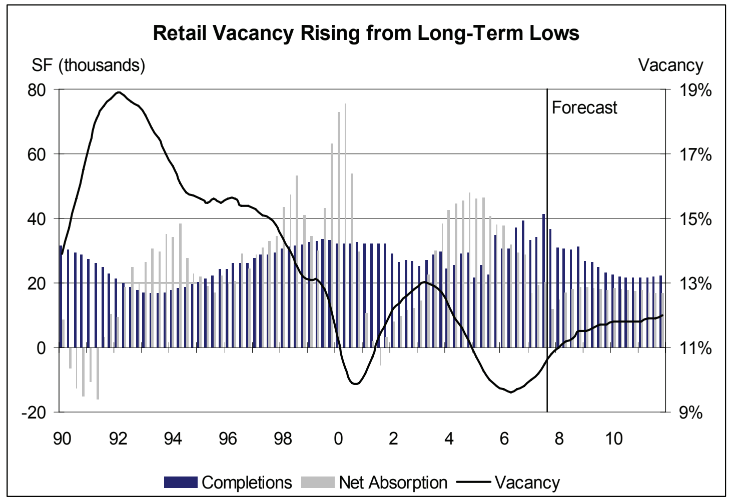
Nevertheless, ongoing food cost inflation due to bio-fuel demand and increased global demand is a concern for grocers, with food price inflation expected to be around 4% in 2008, which is about the same as in 2007. As a result, grocers expect some trading down by consumers. To remain profitable, some grocers are expanding their private-label offerings. Looking ahead, some grocers expect 2008 sales growth around 2.5% to 3%, with most of the increase coming from inflation. Only a small portion of this growth should be due to true sales gains as consumers begin trading down.

Target Market Focus: Retail

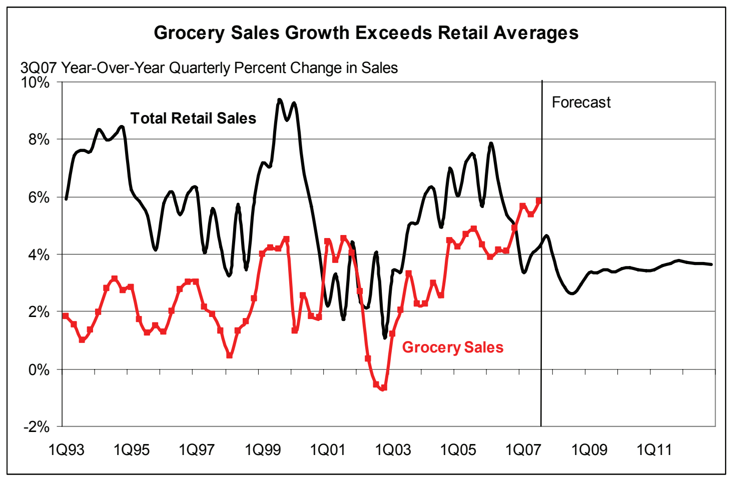
Due to the housing market slowdown and tightening of credit, the consumer-led portion of the US economy shrank in 2007. Looking ahead, consumer-led growth isn't expected to pick up strength until 2009, with business-led economic growth expected to be a key driver of growth over the next few years.

As a result of slowing consumer-led economic growth, net absorption of retail space is forecast to slow as well. Although forecast supply on a national level is expected to decrease from its historical average, retail vacancy on a national level is expected to increase over the next three years. Over this time period, some metros should perform better than others. Metros with stable housing prices, such as Seattle and Portland, should experience similarly stable retail demand, while metros with declining housing prices, such as Las Vegas and Phoenix, should experience declines in demand. In addition, metros with small supply pipelines, such as San Francisco and Washington, are expected to perform better than metros with large supply pipelines, such as Austin and Nashville.

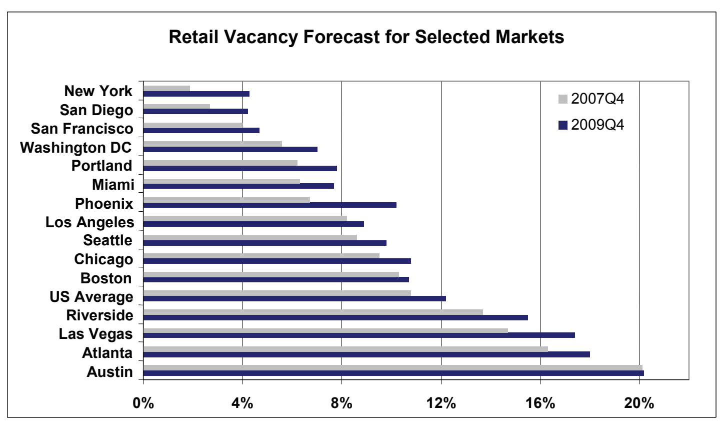
American's strategy in the current market is primarily to underweight the retail sector versus office and industrial. Within the retail sector, our strategy is to focus on "needs-based" retail, such as grocery anchored centers, as the grocery category is experiencing above-average demand growth. In markets that are not oversupplied and that are experiencing stable home values, we target "best in class" grocers with top market shares, as the strength of these retailers tends to support higher occupancy and rental rates.



Source: PPR



Source: Economy.com



Source: PPR

Key Indicators

Interest Rates	1/17/2007	12/11/2007	1/11/2008
10-Year Treasury Yield	4.79%	3.98%	3.82%
CMBS AAA Yield	5.06%	5.49%	5.30%
CMBS BBB Yield	5.52%	11.98%	12.82%
Cap Rates	**4Q2006**	**3Q2007**	**4Q2007**
CBD Office	6.2%	5.5%	5.9%
Suburban Office	7.1%	7.1%	6.9%
Industrial	7.2%	7.6%	7.3%
Multi-Family	6.2%	6.2%	6.3%
Strip Center Retail	6.9%	6.8%	7.1%
12 Mo Private Real Estate Returns	**4Q2006**	**3Q2007**	**4Q2007**
NCREIF-All Properties	16.6%	17.3%	15.9%
Office	19.2%	22.8%	20.5%
Industrial	17.0%	16.6%	15.0%
Multi-Family	14.6%	13.3%	11.4%
Retail	13.4%	13.0%	13.5%
Vacancy	**4Q2006**	**3Q2007**	**4Q2007**
Office	11.2%	11.0%	11.2%
Industrial	9.7%	9.6%	9.7%
Apartment	4.8%	4.2%	4.7%
Retail	9.8%	10.4%	10.8%
Employment	**Dec. 2006**	**Nov. 2007**	**Dec. 2007**
Unemployment Rate	4.4%	4.7%	5.0%
Total Employment Monthly %	0.17%	0.08%	0.01%
Total Employment Yr/Yr	1.68%	1.12%	0.97%

Source: Lehman, NCREIF, Torto Wheaton Research, PPR, Real Capital Analytics, Economy.com, US Treasury

AMERICAN
REALTY ADVISORS

Institutional Real Estate Investment Management

For more information regarding
American Realty Advisors, please contact:

Jay Butterfield, CFA
Managing Director, Fund/Separate Accounts
801 North Brand Boulevard, Suite 800
Glendale, CA 91203
Phone: (818) 545-1152 ▪ Fax: (818) 545-8460
butterfield@americanreal.com ▪ www.americanreal.com

ATLANTA ▪ GLENDALE ▪ CHICAGO