Market Focus
Chicago Retail Market

Chicago’s retail market remains upbeat as national and specialty retailers consider Chicago a strategic market. Resilient consumer demand supported by cash from home mortgage refinancing has kept retail sales humming during the past three years. Retailers benefit from a strengthening economy as people return to work, which fuels increased spending. Recently, higher energy costs and increased interest rates have taking some steam out of retail sales. Target Corp. and WalMart Stores, Inc. reduced their sales forecast for the balance of this year. The addition of 1.2 million jobs since January and the resulting increase in wages should offset any temporary retail sales disappointment.

CONSTRUCTION UNDER CONTROL
The Chicago retail market provides excellent investment fundamentals for investors. Demand by national and specialty niche retailers pushed vacancy rates lower to 8.0% in the second quarter and construction activity remains under control. Approximately 6 million square feet of retail development is slated for delivery in 2004. 40% of new construction is pre-leased to big-box national tenants with the balance available in multi-tenant shopping centers.

Retail development follows residential high growth corridors, with the Southwest Suburbs experiencing the fastest rate of growth. The Romeoville to Plainfield area and Orland Park to Joliet corridor is scheduled to deliver 11 new shopping centers this year and 9 new centers in 2005. The acceleration of development runs the risk of getting ahead of the residential growth.

Other dynamic retail markets include the Far West Suburbs of Algonquin and the hot Randall Road corridor between Batavia and Elgin. The North Suburbs is the tightest market at 5.5% vacancy, as national chains and niche retailers seek locations that offer access to high-income areas. In-fill corner sites in the City of Chicago command the highest rents in the market as retailers capitalize on the population densities and purchasing power in under-served markets.

CAP RATES REMAIN LOW
Competition for single-tenant net-leased investments is fierce. Retailers such as Home Depot, Lowe’s Co., Target Corp., and WalMart Stores, Inc. started a trend of purchasing their own stores. The result is the lack of supply of quality net-leased opportunities able to satisfy the overwhelming demand from investors and 1031 exchange candidates. Capitalization rates for net-leased products trade in the 7% to 7.5% range, and reaches sub-7% in the best markets. The limited supply of investment product also drives the capitalization rates of newer well-located shopping centers from 8% to 8.5%.

Despite a decrease in vacancy, average rents remain steady at $20.10 per square foot. We predict slow rental growth as new construction in most sub-markets limits the ability of landlords to drive rents higher.

Overall, the Chicago retail market remains on the radar screen of most national tenants and investors. The improving economy combined with a controlled supply of new construction enforces our favorable forecast of this preferred asset class.

Rate Check
The Impact of Higher Interest Rates on Commercial Real Estate

The days of record low commercial real estate mortgage rates are over. How does it impact the commercial real estate market? Interest rates are trending up based on signs of a strengthening economy and job growth that increase the likelihood of increased inflation. The Federal Reserve raised the U.S. benchmark interest rate by a quarter-point to 1.25% in late June — the first rate increase since May 2000. The Federal Reserve carefully telegraphed the increase in rates weeks preceding the announcement by stating a desire to tighten policy at a “measured” pace, thus avoiding a repeat of the market turmoil create in 1994 by the surprisingly quick tightening of fiscal policy. Further hikes are expected on the federal funds rate as future contracts show traders expect the Federal Reserve to raise rates a full percentage point between now and December.

TREASURY YIELDS RISING
Prior to the Federal Reserve announcement, the bond market reacted to anticipated interest rate hikes by finishing the second quarter 2004 with the largest quarterly loss in 24 years. The rapid decrease in bond prices during the quarter raised yields on 10-year Treasury notes, a benchmark for commercial real estate mortgages, over 100 basis points starting at 3.84% and at one point rising to 4.9%. Yields stabilized at the end of the quarter to 4.4% on news that the Federal Reserve plans on sticking to its plan of “measured” rate increases based on changing “economic prospects.”

There remains enough uncertainty about the economy to provide support for a “measured” approach to monetary policy. High energy prices and the slower pace of home mortgage re-financings jeopardizes consumer spending, the primary force bringing us out of the recent recession. General Motors, Intel Corp., Target and WalMart downgraded earnings forecast as overall retail sales declined 1.1% in June. Consumer prices did rise a modest 0.2% in June, while the trade deficit decreased 4.5%, but the economy added only 112,000 jobs — less than half the number that economists had predicted. Given these mixed economic signals, we predict a modest rise in commercial mortgage rates through the end of the year.

An increase in rates may not be as detrimental to the commercial real estate market as feared. Rates are rising for a reason: the economy is improving, currently at a 4.5% annualized rate. The economy created 1.2 million jobs since January, and manufacturing production is rising with consumer confidence at a two-year high. Each measure is critical to improving the demand for commercial space. Now that the underlying fundamentals are poised to improve with a growing economy, we predict that investors have reason to more aggressively underwrite net operating income projections. As occupancies increase and rental rates continued on page 2...
stabilize or rise, real estate values should keep pace with incremental increase in the cost of debt.

Since the stock market bust of 2000, the real estate sector has experienced a ferocious influx of capital searching for real estate and its tangible assets. Rising interest rates may cause a flight of capital out of real estate (and reduction in buyers) as yields on alternative investments rise. The flow of capital is fickle and may exit an asset class as quickly as it enters. Although institutional and entrepreneurial investors are more comfortable with the discipline of the capital markets and transparency of information that is now standard practice in real estate. We believe that the recent steady performance of real estate in a fundamentally weak market provides a compelling reason for investors to increase allocations of capital into real estate.

We are bullish on the prospects of continued appreciation in real estate even in a rising interest rate environment. While a sudden and aggressive tightening of monetary policy may restrict values in the short term, real estate has been a proven winner over the long term.

MJ PARTNERS SALES/LEASES/FINANCINGS

- Westwood Springs Apartments, 7940 Janes Avenue, Woodridge, Illinois. 542-unit garden-style apartment complex
  Sale price: $34,000,000
- LifeStorage, 2775 Bode Road, Hoffman Estates, Illinois. 108,000 sq. ft., 768 units.
  Sale price: $8,825,000
- Harwood Heights Self Storage, 59,125 sq. ft., 667 units in lease-up. Sale price: $5,400,000
- 2313 W. 95th Street, Chicago, Illinois. 31,000 sq. ft., retail building sold for redevelopment. Sale price: $1,975,000
- 6901 N. Lincoln Avenue, Lincolnwood, Illinois. 6,221 square foot office building. Sale price: $585,000

MJ PARTNERS LISTINGS

- Mt. Holly Self Storage and Manchester Self Storage, New Jersey. Two single-story self storage facilities, 102,200 sq. ft., 895 units, over 90% occupied. List price: $8,000,000
- Derby Self Storage, Nashville, Tennessee. 74,720 sq. ft., 695 units, 75% occupied.
  List price: $4,100,000
- 24 Hour Self Storage, 143 E. Lake Cook Road, Palatine, Illinois. 49,150 sq. ft., 340 units, 80% occupied.
  List price: $4,000,000
- 19800 S. LaGrange Road, Mokena, Illinois. 7.37 acre retail development site may divide.
  List price: $3,850,000
  List price: $3,200,000
- 1st Security Self Storage, Cincinnati, Ohio. 76,446 sq. ft., 549 units, 5-stories, $520,000 annual income, 96% occupied.
  List price: $3,100,000
- 143 Acre Development Site, Crete, Illinois. Kings Road at Old Monee Road. High density residential development land.
  List price: $2,145,000 or $15,000 per acre
- The Plaza Regional Mall Site, 95th Street and Western Avenue, Chicago, Illinois. 45,000 sq. ft., pad site.
  List price: Available Upon Request
- 21st and Morgan Streets, Chicago, Illinois. 1.68 acre Pilsen development site adjacent to Alivio Medical Center.
  List price: $750,000

Other News

- Andrew S. Becker has joined MJ Partners as a Senior Associate specializing in investment real estate dispositions and leasing.
- Sandy Breitowich has been promoted to Assistant Vice President.