The Retail Sector Encounters The “Soft Patch”

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Retail Sector Issues

• The Consumer is No Longer in the Driver Seat of the Economy
• The State of the Retail Industry – Experiencing the Soft Patch
• The State of the Consumer - Mixed
• Gasoline Price Impacts
• 2004 Christmas Outlook & Beyond
Business Spending Takes the Lead Over Consumer Spending

Consumption Expenditures vs. Business Fixed Investment Inflation Adjusted

TQSAR = Two-Quarter Smoothed Annualized Rate.

Sources: U.S. Department of Commerce; ICSC Research.

Retail Sector Encounters the Soft Patch – Where?

Motor Vehicle Leading Indicator Signals Softness in Key Discretionary Spending Component...But Indicator has been Improving in Last Two Months

ICSC Leading Indicator of Motor Vehicle Sales vs. Motor Vehicle Sales

Source: ICSC Research.
The State of the Non-Auto Retail Industry

The Soft Patch Through the Eyes of the Industry

The ICSC Shopping Center Executive Opinion Survey found that industry business conditions improved in August 2004, but the pace of the improvement was a tad softer than the same time of 2003.

ICSC Shopping Center Executive Component Diffusion Indexes (%)

<table>
<thead>
<tr>
<th>Components</th>
<th>Aug '04</th>
<th>Sep '04</th>
<th>Oct '04</th>
<th>Nov '04</th>
<th>Dec '04</th>
<th>Jan '05</th>
<th>Feb '05</th>
<th>Mar '05</th>
<th>Apr '05</th>
<th>May '05</th>
<th>Jun '05</th>
<th>Jul '05</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current Conditions</td>
<td>54.657</td>
<td>50.057</td>
<td>55.658</td>
<td>56.056</td>
<td>55.455</td>
<td>56.055</td>
<td>55.857</td>
<td>53.553</td>
<td>65.654</td>
<td>3</td>
<td>3</td>
<td></td>
</tr>
<tr>
<td>Sales</td>
<td>56.859</td>
<td>56.364</td>
<td>56.261</td>
<td>56.060</td>
<td>55.959</td>
<td>51.159</td>
<td>52.652</td>
<td>56.756</td>
<td>35.6</td>
<td>1</td>
<td>1</td>
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</tr>
<tr>
<td>Customer Traf</td>
<td>57.457</td>
<td>54.062</td>
<td>54.263</td>
<td>54.661</td>
<td>54.662</td>
<td>56.060</td>
<td>56.258</td>
<td>57.857</td>
<td>95.8</td>
<td>5</td>
<td>5</td>
<td></td>
</tr>
<tr>
<td>Occupancy Rate</td>
<td>57.762</td>
<td>55.854</td>
<td>55.055</td>
<td>55.853</td>
<td>55.353</td>
<td>53.357</td>
<td>58.856</td>
<td>85.8</td>
<td>49.4</td>
<td>9</td>
<td>9</td>
<td></td>
</tr>
<tr>
<td>Rent Spread</td>
<td>52.151</td>
<td>56.557</td>
<td>55.854</td>
<td>55.254</td>
<td>85.454</td>
<td>95.459</td>
<td>35.954</td>
<td>152.657</td>
<td>9</td>
<td>9</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Capitalization Ratio</td>
<td>48.953</td>
<td>46.849</td>
<td>45.252</td>
<td>43.551</td>
<td>42.551</td>
<td>42.551</td>
<td>44.742</td>
<td>54.714</td>
<td>54.354</td>
<td>44.2</td>
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<td></td>
</tr>
</tbody>
</table>

Note: Capitalization ratio diffusion indexes are inverted to capture the effect that a higher capitalization rate will lower the value of the property, other things being equal.
How Is the Shopping-Center Industry Performing?

The New Katona Paradigm
For Understanding Consumer Spending Motivation

Original Paradigm
Consumer Spending = f(Ability to Spend, Willingness to Spend)

The Expanded Katona Paradigm

Motivation for Spending
A Closer Look: Store Sales Growth Rate Trends Weaken
Sustainable Pace About 3% For Remainder of Year

The Relative Sales Story
August 2004 Comp-Store Industry Sales Grew By 1.1% Year/Year

Even the Once Mighty Discount Sector Has Slowed Sharply
A Further Look at Sector Sales Performance

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Apparel Specialty Sales vs. Industry Comparable-Store Sales Performance

Discount Store Sales vs. Industry Comparable-Store Sales Performance

Department Store Sales vs. Industry Comparable-Store Sales Performance

Wholesale Club Sales vs. Industry Comparable-Store Sales Performance

Source: ICSC Research.

Retail Sector Encounters the Soft Patch — Why

Causes of the Economic Soft Patch and Why It Lingers

U.S. Regular Gasoline Prices

Dollars Per Gallon, Including Taxes

High Gasoline Prices…

But prices have receded a bit since late May record high.

Data Through September 6, 2004

Source: U.S. Energy Information Administration.
Examining the Gasoline Price Impact

How Sensitive are Store Sales to Gasoline Price Swings?
Estimated Consumption Function, November 1996 - April 2004

<table>
<thead>
<tr>
<th>Store/Store Type</th>
<th>August 2004</th>
<th>Chart to Right: How much more is the consumer spending for gasoline relative to the increase in average weekly earnings?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wholesale Furniture</td>
<td>-0.21</td>
<td>Average Expenditure Per Week for Gasoline:</td>
</tr>
<tr>
<td>Discount Stores</td>
<td>-0.66</td>
<td>Early September $26.70  May 2004 $28.60  December 2003 $21.30</td>
</tr>
<tr>
<td>Department Stores</td>
<td>-0.34</td>
<td></td>
</tr>
<tr>
<td>Drug Stores</td>
<td>-0.31</td>
<td></td>
</tr>
<tr>
<td>Footwear</td>
<td>-0.21</td>
<td></td>
</tr>
<tr>
<td>GAFO Sales</td>
<td>-0.14</td>
<td></td>
</tr>
<tr>
<td>Wholesale Clubs</td>
<td>-0.13</td>
<td></td>
</tr>
<tr>
<td>Apparel Specialty</td>
<td>-0.11</td>
<td></td>
</tr>
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</table>

Discounters most sensitive sector to high gasoline prices.

Retail Sector Encounters the Soft Patch – Why
Short-Term Demographics Turned Negative

Household Formation & Chain Store Sales
Household Formation Growth Leads By 12 Months

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Consumers React to Price Volatility (as Uncertainty) and Curtail Spending

The Kallona Effect and U.S. Consumer Spending
Volatility in the Consumer Price Level Inverted

Consumer Debt Trends

Bank’s Willingness to Lend to Consumers and Durable Goods Spending

Home Equity Loan Demand

Household Debt Service Ratio
But Not Everything is Negative…
Some Sources of Income Are Improving

Interest and Dividend Income Account for about 14% of Personal Income. These two categories of “passive income” have started to rise more rapidly this year.

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Consumer Fundamentals…

The Diderot Effect Still Exists

Home Demand as a Trigger for the Diderot Effect
Nine-Month Lead Time

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Source: US Department of Commerce CEC Research
Holiday Sales Outlook and Beyond

Stocking Those Racks and Shelves
Can The Ordering Flow of Apparel Tell Us About Retailers' Holiday Expectations?

[Graph showing Apparel Imports with percentage change from prior year for years 1998 to 2004]
Changing Importance of Christmas Sales

November-December GAFO Sales as Share of Annual Sales
Shifting Importance of Christmas Sales

2004 Christmas Sales Expectations

Table 1
U.S. Chain Store Holiday Sales
Year/Year Percentage Change

<table>
<thead>
<tr>
<th>Year</th>
<th>Nov</th>
<th>Dec</th>
<th>Average</th>
<th>Inflation</th>
<th>Real Spending</th>
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<tbody>
<tr>
<td>1990</td>
<td>1.3</td>
<td>2.7</td>
<td>2.0</td>
<td>3.4</td>
<td>-1.4</td>
</tr>
<tr>
<td>1991</td>
<td>2.4</td>
<td>2.6</td>
<td>2.5</td>
<td>4.1</td>
<td>-1.6</td>
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<tr>
<td>1992</td>
<td>3.8</td>
<td>7.4</td>
<td>5.6</td>
<td>2.6</td>
<td>3.0</td>
</tr>
<tr>
<td>1993</td>
<td>3.1</td>
<td>4.2</td>
<td>3.6</td>
<td>1.6</td>
<td>2.0</td>
</tr>
<tr>
<td>1994</td>
<td>3.6</td>
<td>4.1</td>
<td>3.8</td>
<td>1.4</td>
<td>2.4</td>
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<tr>
<td>1995</td>
<td>2.6</td>
<td>1.6</td>
<td>2.1</td>
<td>1.7</td>
<td>0.4</td>
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<tr>
<td>1996</td>
<td>2.9</td>
<td>3.4</td>
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<td>1.0</td>
<td>2.1</td>
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<td>1997</td>
<td>4.1</td>
<td>4.9</td>
<td>4.5</td>
<td>0.4</td>
<td>4.1</td>
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<td>1998</td>
<td>4.5</td>
<td>5.7</td>
<td>5.1</td>
<td>1.2</td>
<td>3.9</td>
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<td>1999</td>
<td>4.1</td>
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<td>2000</td>
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<td>2001</td>
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<td>2.2</td>
<td>2.2</td>
<td>-0.3</td>
<td>2.5</td>
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<tr>
<td>2002</td>
<td>0.0</td>
<td>1.0</td>
<td>0.5</td>
<td>-1.5</td>
<td>2.0</td>
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<tr>
<td>2003</td>
<td>3.7</td>
<td>4.3</td>
<td>4.0</td>
<td>-2.5</td>
<td>6.5</td>
</tr>
</tbody>
</table>

2004 est. --- --- 3.6 to 4% -1.1 4 to 5%

NOTE: Sales are based on the monthly ICSC Chain Store Sales Index, which is a composite of chain store sales on a comparable store basis. Inflation is based on the Consumer Price Index for commodities less food and energy or December-over-December percentage change basis, except for 2004 which is based on July 2004.

Table 2
Tracking GAFO Holiday Sales
Year/Year Percentage Change

<table>
<thead>
<tr>
<th>Year</th>
<th>November</th>
<th>December</th>
<th>Nov-Dec</th>
</tr>
</thead>
<tbody>
<tr>
<td>1990</td>
<td>9.8%</td>
<td>8.6%</td>
<td>6.6%</td>
</tr>
<tr>
<td>1991</td>
<td>6.7%</td>
<td>6.2%</td>
<td>4.2%</td>
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<tr>
<td>1992</td>
<td>4.7%</td>
<td>4.3%</td>
<td>2.5%</td>
</tr>
<tr>
<td>1993</td>
<td>3.8%</td>
<td>4.0%</td>
<td>3.9%</td>
</tr>
<tr>
<td>1994</td>
<td>5.7%</td>
<td>6.4%</td>
<td>6.1%</td>
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<tr>
<td>1995</td>
<td>6.8%</td>
<td>9.4%</td>
<td>4.8%</td>
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<tr>
<td>1996</td>
<td>6.8%</td>
<td>9.4%</td>
<td>4.8%</td>
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<tr>
<td>1997</td>
<td>6.8%</td>
<td>9.4%</td>
<td>4.8%</td>
</tr>
<tr>
<td>1998</td>
<td>6.8%</td>
<td>9.4%</td>
<td>4.8%</td>
</tr>
</tbody>
</table>

2004 est. 5.5% 4.5% 5.0%

Sources: ICSC Research
Retail Sector Encounters the Soft Patch – Where?

Looking Ahead: What’s In Store For Sales?
Leading Indicator Suggests a Roller Coaster over the Next Year—But Reasonably Healthy Trend

ICSC's Chain Store Sales Leading Index vs. Chain Store Sales 12-Month Lead Time in Leading Indicator

% Change from Prior Year

Leading Indicator Suggests a Roller Coaster over the Next Year—But Reasonably Healthy Trend

Thank You