STATE OF THE NATIONAL RETAIL MARKET: THIRD QUARTER 2002

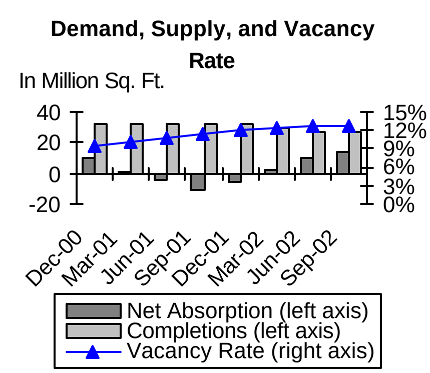
Vacancy. Consumers remain the economy's driving force, despite their somber mood in the third quarter of 2002. Household spending on goods and services grew at an annual rate of 4.1 percent –- the strongest showing of the year. This lifted overall retail sales, excluding autos, 1.9 percent. The housing sector also posted healthy numbers, as consumers continued to commit a sizable portion of their income to the purchase of homes. Why all this spending? Incomes are well above the pace of inflation. Disposable income was up at an annual rate of nearly five percent in the third quarter of 2002, while consumer prices rose marginally (1.8 percent). Consumer buying power is also getting a boost from record refinancing activity. Extra money from liquidating their home equity and lower monthly payments gave consumers additional buying power in the third quarter.

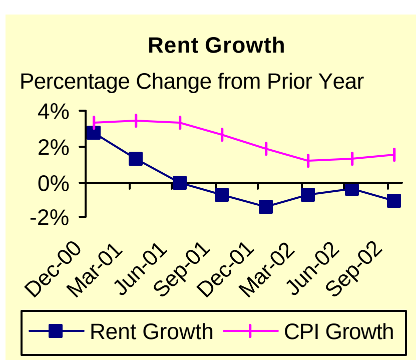
Thanks to the resilience of consumers, demand slowdown in the retail sector was one of the shallowest on record. After four consecutive quarters of negative growth, demand growth finally turned positive (+0.4 percent). Forty-three markets, led by Dallas-Fort Worth, Inland Empire, and Los Angeles, reported healthy absorption rates. Aggregate net absorption in all 54 markets tracked rose from –10.9 million square feet (msf) in the third quarter of 2001 to 13 million msf in the third quarter of 2002. This raised net absorption to 25.6 msf in all 54 markets for the nine months ending September 30, 2002.

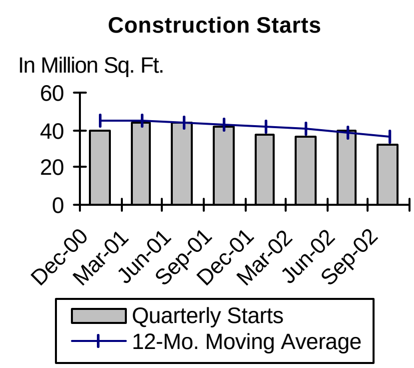
Meanwhile, total stock of retail space in the 54 markets grew 2.3 percent from the third quarter in 2001 –- noticeably faster than the increase in demand. Even though completions of new retail space eased from year-ago levels, they remained high at 27 msf in the third quarter of 2002 as 23 markets reported an increase in deliveries of new retail space compared to the same period in 2001. That brought the year-to-date retail completions in the 54 markets to 82.5 msf. Consequently, the average vacancy rate was 12.8 percent in the third quarter of this year, up 20 basis point from last quarter and 150 basis points from the third quarter of 2001. Only Inland Empire and Richmond bucked the vacancy uptrend, as demand grew more rapidly than supply in these markets. Overall, 20 markets reported vacancy rate that was still below the average for the 54 markets.

Rent. Despite healthy retail sales, particularly among discount retailers, higher vacancies continued to weigh down on the pricing power of retail owners. Average rent for retail properties in the 54 markets dipped 1.1 percent in the third quarter of 2002 from the same period in 2001. Seventeen markets posted rent increases ranging between 0.1 percent and 3.8 percent from the third quarter in 2001. While average rent in the 54 markets has continuously slipped since the second half of 2001, the good news is that it is just 2.1 percent down from its peak rate in 2000.

Construction Starts. Sales of retail properties were brisk in most of the 54 markets, but construction was moderate in the third quarter of 2002. Developers were hesitant to start construction unless properties could be largely pre-leased. As a result, retail starts in the 54 markets trended down to 32 msf, the lowest since the first quarter of 1997. This largely reflects the marked slowdown in construction activity in 34 markets from the third quarter 2001. Year-to-date, construction starts in the 54 markets totaled 108.1 msf, well below the 130.1 msf under construction in the first nine months of 2001. Los Angeles, Dallas-Fort Worth, Houston, and Atlanta accounted for 20 percent of total year-to-date starts.







Source: Property and Portfolio Research, Bureau of Labor Statistics

KEY MARKET TRENDS: THIRD QUARTER 2002

Markets with Highest Occupancy

Market	Vacancy Rate	Change from Prior Year
East Bay, CA	7.7%	40 bps
New York, NY	7.7%	50 bps
San Francisco, CA	8.0%	60 bps
Boston, MA	8.5%	130 bps
Long Island, NY	8.5%	80 bps
San Diego, CA	9.2%	60 bps
Washington, DC-NoVA-MD	10.2%	70 bps
Ft. Lauderdale, FL	10.4%	0 bps
Orange County, CA	10.6%	130 bps
Seattle, WA	10.6%	100 bps

Source: Property & Portfolio Research

Tight occupancies in New York City and Boston helped the Northeast retain the top spot among all regions in terms of retail occupancy. Interestingly, rents have been steep in most major markets in this region, yet its vacancy rate of 11.1 percent was still the lowest regional figure in the third quarter of 2002. The West followed with a vacancy rate of only 11.6 percent as most major markets reported vacancy rate that was far below the average for the 54 markets. The Midwest and South trailed as vacancy rates stood at 13.1 percent and 14.5 percent, respectively. Relatively flat demand growth in the Midwest and a surge in new retail space in the South explain vacancy increases in the third quarter of 2002.

Markets with Highest Rent Growth

Market	Rent Growth
Inland Empire, CA	3.8%
Norfolk, VA	2.5%
Tampa, FL	2.2%
Kansas City, MO -KS	1.5%
Palm Beach County, FL	1.4%
Northern New Jersey, NJ	1.2%
Long Island, NY	1.2%
San Diego, CA	1.2%
New Orleans, LA	0.8%
St. Louis, MO-IL	0.7%

Source: Property & Portfolio Research

Rent growth leaders in the third quarter of 2002 include Inland Empire, Norfolk, and Tampa. Increased defense spending and an improved trade environment is helping prop up employment and consumer spending in these markets. The Northeast and South reported rents basically unchanged from the third quarter 2001. Rents in the Midwest decreased 1.6 percent, reflecting significant erosion in 14 of the markets in this region. The West posted the most significant rent decline (-1.8 percent), as substantial rent cutbacks remained prolific in tech heavy markets including San Francisco, San Jose, East Bay, Portland, and Seattle. Even so, the average rent in this region was still higher than the national average.

Markets with Highest Construction Starts

Market	Percentage of Total U.S. Starts
Houston, TX	6.9%
Los Angeles, CA	5.8%
Atlanta, GA	4.4%
Dallas - Fort Worth, TX	3.8%
Boston, MA	3.8%
Chicago, IL	3.6%
Phoenix, AZ	3.6%
Las Vegas, NV	3.5%
Northern New Jersey, NJ	3.5%
New York, NY	3.0%

Source: Property & Portfolio Research

The largest retail markets –- Houston, Los Angeles, Atlanta, Dallas-Fort Worth, Boston, Chicago, and New York City –- dominated the construction pipeline, accounting for 30 percent of starts in the third quarter of 2002. Regionally, the South –- which had the highest vacancy in the third quarter –- recorded the largest volume of retail starts (11.9 msf). It is good news that new construction in most markets in this region already eased from the third quarter of 2001, but there was a notable upturn in development activity among markets characterized by high vacancy rates: Richmond, Memphis, and Jacksonville. The West and Midwest also reported slowing construction, with starts declining 20 percent-plus to 9.9 msf and 4.9 msf, respectively. Only the Northeast experienced increased activity with 5.4 msf of new retail projects.

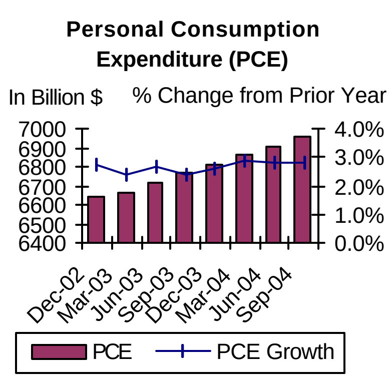
The Retail Outlook

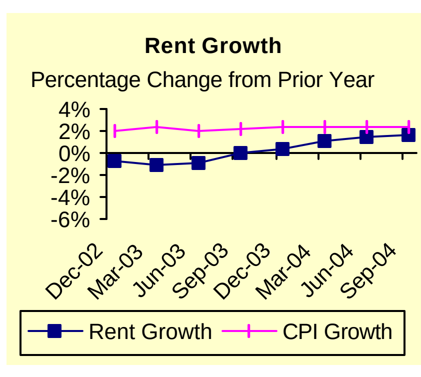
Consumer spending in the fourth quarter is not likely to be as strong as it was in the third, and will just add modestly to economic growth. Why? Retail sales in October were flat, reflecting a plunge in car sales after the summer's generous financing deals were curtailed. Moreover, there are fewer shopping days in the 2002 holiday season compared to 2001. There are also psychological factors such as fear of terrorism that could slam the brakes on spending. Nonetheless, the fourth-quarter consumer outlook has some silver lining. Closer inspection of October retail activity shows that households are still in a buying mood. Excluding cars and gasoline, retail sales were up by a healthy 0.8 percent from September, and the gains were broad-based. In addition, there are factors that could make shoppers loosen their purse strings. Confidence is rebounding. Incomes are growing faster at a faster clip than inflation. Cash from refinancing activity should continue to boost buying power. Also, energy prices have declined.

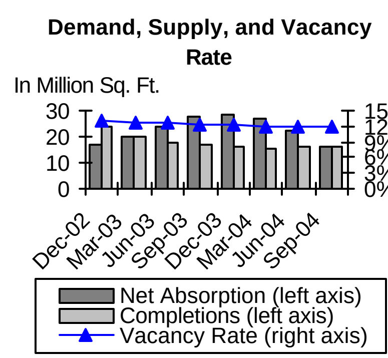
Steadfast consumer spending should help lift demand for retail space in the 54 markets tracked. Net absorption is expected to edge up to 16.6 msf in the fourth quarter, with all 54 markets likely to record positive increases. This should raise the aggregate net absorption to 42.1 msf for all of 2002, a far cry from 19.7 msf that was not absorbed in 2001. Meanwhile, slowing construction over the past year will again translate into fewer retail completions (24.2 msf) in the fourth quarter. However, annual completions will remain uncomfortably high at 106.7 msf, pushing up the average vacancy rate in all 54 markets except Inland Empire, San Diego, Ft. Lauderdale, Richmond, East Bay, New York City, and San Francisco to 12.9 percent by year-end 2002 from 12.0 percent recorded in 2001. There will be little upward movement in rents over the fourth quarter, as owners work to keep space filled. Rents should remain nearly unchanged from 2001 (-0.7 percent).

Beyond the fourth quarter, expect consumer spending to gain momentum, and allow the economy to make solid gains in 2003 and 2004. Improving job prospects will be the main driver of spending: nearly 5 million non-farm jobs are likely to be created in the 54 markets over the next two years. Strength in consumer spending should fuel demand for retail space, with 99.9 msf and 80.5 msf likely to be absorbed in 2003 and 2004, respectively. Likewise, strong consumer spending should spur modest development activity, particularly in those markets with strong absorption rates such as Dallas-Fort Worth, Los Angeles, and Inland Empire. Annual completions in the 54 markets will be lower than their 2002 levels at 70.7 msf and 65.7 msf in 2003 and 2004, respectively, and thus likely to be easily absorbed. Consequently, expect the average vacancy rate to contract to 12.2 percent in 2003 and 11.8 percent in 2004 –- still well above the record low of 9.1 percent in 2000. Only Richmond, Honolulu, Cleveland, St. Louis, and Kansas City are likely to suffer occupancy declines due to an influx of retail space. Though owners would benefit from higher occupancy, they are likely to be hesitant to bump up rents. Average rent in the 54 markets is expected to rise moderately: 0.5 percent in 2003 and 1.6 percent in 2004.

Hot Markets. Approximately 21 retail markets tracked should rebound more rapidly in the next two years, as strong demographic and job trends shore up their retail occupancies above the average for the 54 markets. Salt Lake City, Austin, Stamford, and Milwaukee will be the growth leaders among markets with less than 60 msf of retail space. East Bay, San Francisco, Long Island, Sacramento, Seattle, Ft. Lauderdale, Portland, Minneapolis, and San Jose will top markets between 60 msf and 110 msf, while, San Diego, New York City, Boston, Orange County, Washington DC, Chicago, Los Angeles, and Phoenix will lead markets among those with more than 110 msf of retail space.







Source: Property and Portfolio Research, NATIONAL ASSOCIATION OF REALTORS®

The markets covered in this report include the following:

Atlanta, GA	Minneapolis, MN-WI
Austin, TX	Nashville, TN
Baltimore, MD	New Orleans, LA
Boston, MA	New York City, NY
Charlotte-Gastonia, NC-SC	Norfolk, VA
Chicago, IL	Northern New Jersey
Cincinnati, OH-KY-IN	Oklahoma City, OK
Cleveland, OH	Orange County, CA
Columbus, OH	Orlando, FL
Dallas-Fort Worth, TX	Palm Beach County, FL
Denver, CO	Philadelphia, PA-NJ
Detroit, MI	Phoenix, AZ
East Bay, CA (Formerly Oakland)	Pittsburgh, PA
Fort Lauderdale, FL	Portland, OR
Hartford, CT	Raleigh, NC
Honolulu, HI	Richmond, VA
Houston, TX	Sacramento, CA
Indianapolis, IN	Salt Lake City-Ogden, UT
Inland Empire (Formerly Riverside, CA)	San Antonio, TX
Jacksonville, FL	San Diego, CA
Kansas City, MO-KS	San Francisco, CA
Las Vegas, NV	San Jose, CA
Long Island, NY	Seattle, WA
Los Angeles, CA	Stamford, CT
Memphis, TN	St. Louis, MO-IL
Miami, FL	Tampa-St. Petersburg, FL
Milwaukee, WI	Washington, DC-MD-VA

Commercial Real Estate Quarterly is published four times a year by the Research Division of the NATIONAL ASSOCIATION OF REALTORS® for the Realtors® Commercial Alliance (RCA). The RCA, formed by NAR in 1999, serves the needs of the commercial market and the commercial constituency within NAR, including commercial members; commercial committees, subcommittees and forums; commercial real estate boards and structures; and NAR affiliate organizations. These organizations include the CCIM Institute, the Institute of Real Estate Management, the Realtors® Land Institute, the Society of Industrial and Office Realtors®, and Counselors of Real Estate. The RCA also provides commercial products and services. REALTOR®, REALTORS®, and REALTOR ASSOCIATE® are registered collective membership marks that identify, and may be used only by, real estate professionals who are members of the NATIONAL ASSOCIATION OF REALTORS® and subscribe to its strict Code of Ethics.