A Professional Opinion

Review of Grocery Impacts:
Perris Marketplace

As Discussed In:
Market Impact Analysis for Perris Marketplace
August 22,2006

Prepared For:
Gresham Savage Nolan & Tilden

Prepared By:
The Natelson Dale Group, Inc.

Proprietary Report Prepared For:
John G. McClendon

Attorney-Client Work Product
Leibold McClendon & Mann

Report Prepared By:
Regulatory Economics, Inc.
Las Vegas, NV.
(702) 407-0065

Primary Author:
Prof. Alan Schlottmann

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Note: This report is designed solely to facilitate public discussion of the issue. The forecasted figures serve only as general forecasts of possible results that are based upon limited data. Any change in assumptions or existing conditions will yield alternative results, and actual results may change substantially. The validity of assumptions is subject to the reliability of the cited sources and materials as provided by the attorneys. Thus, we highly encourage other analyses which include additional data refinements to more completely develop this topic for public discussion. Although accuracy was strived for, any use of the presented figures requires independent validation since no claims, guarantee, or warranty of accuracy are made.

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I. Introduction

This professional opinion relates to suggested impacts on the grocery sector of the proposed grocery operations at Perris Marketplace presented in the document titled “Market Impact Analysis for Perris Marketplace”.[1]

The Basic Issue for City of Perris, California

Our understanding of the submitted document is that it claims there will be little or no significant impact on the current grocery retailers; that is, no negative impacts:[2]

> *“It is TNDG’s conclusion that the proposed project’s grocery sales will not have significant negative impacts on existing supermarkets [page 8]”*
>
> *“However, TNDG believes that these effects would be temporary and would not be severe enough to threaten the long-term viability of the existing stores [page 9]”*
>
> This view of temporary is expressed even though the report initially states:
>
> *“Thus, it is likely that the proposed project will result in reduced sales volumes at the existing stores [page 9]”.*

In our opinion, it appears that the submitted report reconciles these somewhat inconsistent statements through the three sentences in the section titled “*Conclusion regarding Significance of Impact”* [page 9]:

“TDNG estimates the current sales volume of the existing Perris supermarkets at approximately $865 per square foot. This is significantly higher than the industry median (for the supermarkets in the Western U.S.) of about $400 per square foot……”

“TDNG projects that in 2007 the sales volume at the existing supermarkets would decrease to an average of $803 per square foot-a level which is still well over the regional industry “benchmark” of approximately $400 per square foot.”

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[1] Specifically, the document received from the City of Perris with a publication date of August 22, 2006 as prepared for Gresham, Savage, Nolan, and Tilden by The Natelson Dale Group, Inc. [TNDG].

[2] All page numbers relate to the numbering within an adobe acrobat version of the report [in general, subtract three for consistency with a printed copy].

"By 2009, TNDG projects that there would be sufficient demand to support average sales volumes at the existing stores of $881 per square foot (in today's dollars)."

Thus, we interpret these assertions as suggesting that existing Perris supermarkets are both currently extraordinary generators of revenue (compared to the $400 figure) and will continue to be so in the future.

The opinion below is highly critical of these high value estimates and suggests a series of questions for the City of Perris to ask for clarification.

Specifically, we propose five questions that need clarification.

To put the opinion below in perspective, we contrast the suggested dollar figures above with our estimates for a private client interested in retail location within the Forum Shops at Caesar's Palace, Las Vegas, Nevada.

II. Supermarket Revenues: Neighborhood Shopping Centers

In our opinion, the TNDG estimates of supermarket revenues per square foot for existing Perris supermarkets are extraordinarily high.[3] In our opinion, these estimates are both outside the realm of our experience and the general literature below documenting sales figures per square foot.

The data presented below is based upon the most recent 2006 data available from the respected sources of the Urban Land Institute [ULI] and International Council of Shopping Centers [ICSC] as summarized in *Dollars & Cents of Shopping Centers/The SCORE 2006.*[4]

Our understanding of the tone of the TNDG report is that the discussion most nearly fits the ULI definition of a neighborhood center.[5] A neighborhood center provides, for example, for the day-to-day living needs of the immediate neighborhood and is generally associated with activity such as a supermarket (food, drugs, sundries, etc.).

As a starting point of discussion, consider the following two points:

A. The overall data on sales and rents presented in the table below; and

[3] See the TNDG report footnote 12 for a basis description of the estimation method.
[4] All data in table format presented in this section are derivative tables from this source. These tables are not endorsed or sanctioned by either ULI or ICSC. We express full acknowledgement of this source as our data source. The publication and data above had Anita Kramer as Project Director, a study of receipts and expenses in shopping center operations.
[5] A list of alternative types of shopping centers and associated definitions is presented on page 5, ULI-ICSC, op. cit.

B. The TNDG report, Table III-13 [page 29], which shows a potential range over time of sales per square foot (in constant dollars) of existing Perris supermarkets of $865 to $953.

Tenant Classification[6]	Sales Volume per Square Foot of GLA		Total Rent per Square Foot of GLA	
	U.S. Median $	Western Median $	U.S. Median $	Western Median $
Supermarket	349.41	458.41	7.81	10.35
Restaurant with liquor	253.20	458.09	16.08	18.41
Chinese fast food	92.06		13.52	21.78
Dry cleaner	129.69	236.12	17.97	20.16
Nail salon	75.96		14.97	17.55

In our opinion, the TNDG estimates appear extraordinarily high compared to the data presented above. This leads to three important questions for the City of Perris:

Question One: What evidence exists to suggest that supermarkets in the City of Perris, California are perhaps the highest sales generators of all supermarkets not only in California but the United States?

Question Two: If Perris supermarkets really are undisputed leaders in revenues per square foot in both California and the nation, then it would be reasonable to suggest that other retailers in the City of Perris might also be revenue leaders per square foot both in California and the United States within their industries. Is there any evidence to suggest this?

Question Three: If Perris supermarkets are national leading revenue engines, one might expect local retail rents to also be among the highest in California and the nation. Is there any evidence to support this?

III. Top Supermarkets in Revenues

What do the data show for the absolute top supermarkets in the nation (in terms of revenue)?

[6] See footnote 4 for citation; also see footnote 5. The table above is from Table 6-9.

As shown in the data presented below, the estimates presented in the TNDG report also exceed even these extreme figures. In our opinion, it seems warranted to view the TNDG estimates as too high.

Tenant Classification[7]	Sales per Square Foot		
	Top Ten Percent	Median	Top Two Percent
Supermarket	577.10	349.41	703.24

Given the above information, it is interesting to compare several illustrative figures in the TNDG analysis if one uses either the Western regional average of $458.41 per square foot or the US median of $391.41 instead of the very high estimates.

In the report, TNDG shows a potential drop in existing supermarket sales per square foot from $865 in 2004 to $475 in 2007 based upon planned and pending grocery related projects [page 15, Table II-4].[8] This is a drop in revenues per square foot of approximately $400 [$865-$475=$390].

Estimates of Revenues per Square Foot less $390 Fall in Revenues Shown in TNDG Report [Nearest Dollar]

Level	Source	New Figure
$865	TNDG Report	$475
$458	Western Median	$68
$349	U.S. Median	(-$41)

Question Four: If the lower estimates of revenue per square foot consistent with ULI-ICSC data are appropriate, then how much will the existing supermarket sector in the City of Perris contract and how many existing stores fail?

[7] Op. cit. The table above is from the section on detailed tenant information: F. Detailed Tenant Information Tables for U.S. Neighborhood Shopping Centers.

[8] Recall that all page numbers relate to the numbering within an adobe acrobat version of the report [in general, subtract three for consistency with a printed copy].

A Further Complication: Are All Relevant Supercenters Included in the Analysis?

The analysis of the impacts on the current Perris grocery sector in the TNDG report are predicated upon the retail demand analysis within the Primary Market Area [PMA] and the two Secondary Market Areas [SMA] of North and South, respectively.

A visual interpretation of the relevant market areas is provided by TNDG as a map on page 17 of the report [page 14 in a hard copy version]. It is crucial to note that the PMA borders close to Lake Ellsinore, California and, in particular, the area approximately immediately east of Route 74 and I-15. This is not surprising given the road transportation network serving communities in the area.

Obviously, any major grocery operation that impinges upon this market area needs to be included as a potential source of sales leakages negatively impacting grocers in Perris.

It appears that a major omission may have occurred in the TNDG analysis; namely, the possible construction of a Wal-Mart supercenter with grocery operations at east of Route 74 and the I-15 in Lake Elsinore.[9]

If the above information is correct, then the PMA of the Lake Elsinore supercenter will, rather obviously, overlap the Perris PMA. This leads to two relevant queries:

- What reduction in sales in the Perris PMA would be expected given the obvious market area overlap?
- How many grocery operations in Perris would decline to either losses and/or closure?

For illustrative purposes, assume that this additional Wal-Mart supercenter not included in the market analysis would further reduce sales by about 25% of the $390 figure above, that is, approximately an additional $100. The results of this assumption are shown in the table below.

As shown below, the median grocery store in the ULI data for <u>both</u> the Western median and the US median would be making losses and cannot maintain operations forever.

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9 This material and assertion is based upon information that is apparently common knowledge in the shopping center development community. Per conversation with John McClendon, the development of this facility has been widely discussed among retail commercial real estate brokerage and consulting companies for at least the past six months; however, it does not appear to have been included in either public discussion of the proposed Perris facility or the list of proposed grocer additions in the TNDG report in Table II-4, page 15.

It is interesting to note that even the high figure of $865 as used in the TNDG report now falls to $375 which is below the Western median of $458.

Estimates of Revenues per Square Foot less $490 Fall in Revenues
[Nearest Dollar]

Level	Source	New Figure
$865	TNDG Report	$375
$458	Western Median	(-$32)
$349	U.S. Median	(-$141)

The discussion above calls for Question Four to be revisited:

Question Four [Revised]: If the lower estimates of revenue per square foot consistent with ULI-ICSC data are appropriate AND an additional Wal-Mart Supercenter is included in the overlapping Lake Elsinore PMA, then how much will the existing supermarket sector in the City of Perris contract and how many existing stores fail?

IV. An Interesting Comparison: The Forum Shops at Caesar's Palace, Las Vegas, Nevada

Our concern over the use of an $865 per square foot figure for supermarkets can be further explained through additional data comparisons.

The purpose of the following analysis is to simply illustrate what a revenue figure of $865 per square foot implies.

For example, shown immediately below are the dollars per square foot figures for U.S. neighborhood shopping centers in the West. As shown, these are far below any notion of $865 per square foot. Clearly the operating data of ULI-ICSC suggest a much lower figure is appropriate.

	Average	Median	Lower Decile	Upper Decile
Center Sales[10]	**Dollars per Square Foot of GLA**			
	$	**$**	**$**	**$**
All tenants	343.48	353.00	153.48	504.35

[10] Op. cit., the table above is from Table 6.5, U.S. Neighborhood Shopping Centers in the West.

The data above clearly seem low relative to a figure of $865 and suggest doubt upon its efficacy. The only retail experience in our private client work that approaches figures resembling $865 per square foot is the retail shops of:

The Forum Shops at Caesars Palace, Las Vegas Nevada[11]

- Annual Rents: $70 up to $200 per square foot
- Average Daily Visitors to Shops: Some 50,000 visitors
- Annual Visitors: Almost 20,000,000 persons per year
- Average Length of Lease: 10-12 years

Given the high end retailers [Hugo Boss, Bernini Collections, etc.] and the presence of jewelry, average annual sales are reported as an astounding $1,200 per square foot.

For a private retail client interested in a top end location on the Las Vegas strip/casino corridor [a high-end Italian men and women's fashion client], our estimates of possible sales were in a range similar to the suggested $865 sales per square foot of a supermarket in Perris, California. Is this really plausible?

For simple purposes of discussion, below is a visual representation of the retail shopping environment of the Forum Shops:[12]

[Photo on next page; this area blank]

[11] All public data on The Forum Shops reported above is from Case Study: The Forum Shops at Caesar's Palace, *Shopping Center Development Handbook*, ULI Development Handbook Series, 2005.

[12] Photograph used with permission of Geert Sonck, Worldwide Photos [Belgium].

Question Five: Does the City of Perris trade area really generate sales per square foot for supermarkets that are becoming comparable to

some retailers in The Forum Shops? What is the evidence for this either currently or in the future?

V. Conclusions

This professional opinion relates to suggested impacts on the grocery sector of the proposed grocery operations at Perris Marketplace. Specifically, we focus our attention on the document submitted to the City titled “Market Impact Analysis for Perris Marketplace”.

Our understanding of the submitted document is that it claims there will be little or no significant impact on the current grocery retailers, that is, no negative impacts.

It appears to us that claims are made suggesting that existing Perris supermarkets are both currently extraordinary generators of revenue and will continue to be so in the future.

The opinion is highly critical of these high value estimates and suggests a series of five questions for the City of Perris to ask for clarification. These questions are:

Question One: What evidence exists to suggest that supermarkets in the City of Perris, California are perhaps the highest sales generators of all supermarkets not only in California but the United States?

Question Two: If Perris supermarkets really are undisputed leaders in revenues per square foot in both California and the nation, then it would be reasonable to suggest that other retailers in the City of Perris might also be revenue leaders per square foot both in California and the United States within their industries. Is there any evidence to suggest this?

Question Three: If Perris supermarkets are national leading revenue engines, one might expect local retail rents to also be among the highest in California and the nation. Is there any evidence to support this?

Question Four: If the lower estimates of revenue per square foot consistent with ULI-ICSC data are appropriate, then how much will the existing supermarket sector in the City of Perris contract and how many existing stores fail?

Question Five: Does the City of Perris trade area really generate sales per square foot for supermarkets that are becoming comparable to some retailers in The Forum Shops? What is the evidence for this either currently or in the future?