

Focus on Retail

Question of the Week

Are retail property fundamentals still healthy?

Allen Ginsborg

Da' Nile ain't only in Egypt, it's in Denver too. Shopping center sellers are denying the reality of weakening retail fundamentals by holding to old values. Buyers are pricing for a retail future that doesn't look as bright as the past few years. The number of shopping center sales in the United States is 67 percent below the prior two-year average. Translation: The retail investment market looks like a deer in the headlights.

With the demise of conduit debt, balance sheet lenders are back to using realistic loan criteria. No more underwriting upside or rent guarantees, interest only is history, percentage rent is not worth as much, and can you say recourse? Lenders are even looking at a tenant's financials. Imagine that. Loan to value is 65 percent to 70 percent for decent credit and amortization is backing down to 25 years from 30. Spreads



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over matching Treasuries are up 250-plus basis points from last year on top of the impact of the stiffer underwriting. Translation: Buyers are putting up more cash at greater cost for more effort with more risk.

Retailer sales are falling with

consumer confidence as the media amplifies the economy's weakness through a daily barrage of bad news. Wal-Mart and a few deep discounters are bright spots, but most retailers' comp sales are falling along with margins as accelerating costs of fuel, commodities and food hit consumers' wallets. Pier One, Linens-N-Things, Circuit City and others are in bankruptcy or on the verge of it. Translation: Retailers are focused on profitability and survival, not new store openings.

Owners can't count on cap rate appreciation to make their deals work and are returning to creating value through rent appreciation. Current Denver retail vacancy rates have ticked up a bit to 7.5 percent and average market rental rates are flat or declining. Fortunately, retail has not been overbuilt in most Colorado markets. If new retail construction continues to fall, the market should support healthy, well-located centers,

but B and C properties may suffer. Translation: We're all going to have to work harder and more creatively to maintain occupancy rates.

A deer in the headlights doesn't have time for denial; it reacts or gets nailed. When retail owners come out of their malaise, the market will head back toward historic valuations based on solid debt criteria, sales volume based expansion decisions, actual occupancy rates and rent appreciation. Normalized cap rates may move up to their historical 8- to-10-percent range in recognition of risk, fickle retail sales, muddled growth and revised underwriting criteria. Translation: Easy money, ambitious sales projections and unrealistic pro formas are gone.

Retail owners' and tenants' mettle is about to be tested. Maybe that's not such a bad thing for our industry in the long run.▲