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New England retail investment market forecast for 2008: A difficult year to predict

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2007 was a remarkable year for the retail capital markets until the credit crunch set in this August. According to Real Capital Analytics, over $73.1 billion of retail property closed or is under contract nationally on a trailing 12 month basis as of November 2007, compared to $53.6 billion for the preceding 12 month period. Several multi-billion dollar portfolio sales and acquisitions of operating companies were representative of a market that placed a premium on big deals, and supported the notion that a portfolio "premium" existed in the market for shopping centers. Because the anticipated increase in interest rates never materialized, the overabundance of capital and strong retail performance maintained buyers' interest, on both a portfolio and one-off basis.

Sellers of class A centers and "value-add" opportunities were rewarded with aggressive pricing and multiple bidders. However, sellers of class B or C properties continued to experience diminished interest in their properties resulting in less bidding activity. Capitalization rates for Class B and C property moved 50 to 100 basis points higher and generally traded in the 7.0% - 8.0% range, depending on quality, credit, and location, while capitalization rates for Class A property remained stable in the 6.2% to 6.5% range.

The ongoing credit market turmoil has significantly impacted sales activity in the retail capital markets, and created an even larger rift between the market value of Class A centers and other retail property. Additionally, the void in the debt markets created by the CMBS freeze has made financing retail acquisitions more difficult. However, life companies and banks are still providing debt for well-located centers with strong sponsors. The availability of acquisition financing for centers in secondary and tertiary markets, that were being primarily funded by CMBS, is difficult to obtain, thus impacting marketability, demand, and pricing. It is too early to tell where pricing will stabilize, but it is imperative that the market find some footing in order to return to a more steady market environment.

As we enter 2008, we face a litany of unanswered questions about the direction of the economy, the capital markets, and the retail sector. Core quality retail assets are in such short supply, that we expect the demand will continue to be strong; however, there will be less institutional bidders than in the past several years. The uncertainty revolves around the levels of demand and pricing for Class B and C shopping centers moving forward. It is too early to speculate when things will stabilize or how deals will be financed. Pricing will take place on a deal by deal basis, and the fundamentals will be scrutinized much more closely than in recent years past.

Shopping centers anchored by dominant grocers with long-term leases in place, strong tenant sales, and a healthy roster of in-line tenants and/or a second credit anchor tenant, will continue to attract healthy investor interest and strong pricing. The most aggressive buyers of these assets will be institutional or foreign investors that are not dependent on financing to achieve their required returns. Over $14 billion of retail property has been sold to foreign investors through the first 10 months of 2007. With the weakness of the dollar, this trend is expected to continue.

One of the biggest shifts in 2008 may be the end of the portfolio "premium." It is believed that investors will be more selective in their acquisitions moving forward, and will be focused on only buying attractive properties while refusing to accept lesser quality assets at similar pricing as part of a portfolio acquisition.

Power Centers will continue to be attractive to investors, but at cap rates that are likely to exceed 7.0%.

Lifestyle centers and mixed use projects continued to be "hot" this year, but as this asset class matures, investors will increase their focus on actual performance when underwriting potential acquisitions. Demand continued to be high, but investors interested in this product type will proceed with caution moving forward.

The market is truly at an inflection point as we head into 2008. The level of uncertainty that exists eliminates the ability to make any confident predictions as to where things are headed. It is difficult to forecast when the capital markets will stabilize, but we know that there continues to be a record amount of capital available to acquire retail property. Cash will be king in 2008, and certainty of execution will take precedence over trying to squeeze every last penny out of a deal.

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