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Connecticut's primary and single-tenant retail markets continue to improve

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Although fundamentals in some secondary and tertiary markets in Connecticut face challenges, the primary market areas of the state's retail investment sector continue to improve, driven by growth in select local economies over the past year. The vacancy rate for all Connecticut retail properties is forecast to increase 40 basis points to 6.4% by year's end. As a result, average rents are forecast to drop 5.2% to $14.86. These factors have led to a constrained development pipeline, which was responsible for 531,460 s/f in 2011. Total new development will continue to drop to nearly 450,000 total s/f by year's end.

In the New Haven/Fairfield County area, employers will create 3,000 positions through year's end, a 0.4% increase. In 2011, job growth reached 0.3%, aided by strong gains in the education and health services sector. Developers are expected to add 450,000 s/f by the end of the year; most of that development will be located in Fairfield County. Increased demand will outweigh new supply in 2012, allowing vacancy to drop 10 basis points to 7.2%. In 2011, vacancy edged up 30 basis points. Asking rents will rise 0.6% in 2012 to $20.89 per s/f. Cuts in concessions will support a 1.3% increase in effective rents to $18.31 per s/f.

In spite of these slowly improving fundamentals, investment sales activity has improved markedly, particularly in Connecticut's single-tenant net-leased sector. As the demographics and consumer psyche evolve, national retailers are responding by adjusting expansion models and product assortments to meet wider consumer groups. The traditional dynamics of retail are ï¬,uctuating and the lines that separate extreme-value stores, drugstores and big-box stores are becoming less evident. All retail segments are pressing for a broader consumer base, with dollar stores and drugstores selling groceries and value chains such as Wal-Mart offering pharmaceutical drugs in most of their locations.

With demand for single-tenant assets steadily increasing, and a dearth of investment-grade properties being brought to market, buyer interest will likely begin to shift toward assets with shorter lease terms or non investment-grade tenants. Cap rates for the few top-tier assets that do trade are already low and continue to match the historical spread between yields and borrowing costs.

The continued risk of inï¬,ation is becoming a determining factor in investment decisions as the devaluation of the dollar creates additional demand for leases structured with increases that either match or hedge against those risks. In addition, investors who purchased between 2005 and 2007 may generally experience difficulty in refinancing properties due to the equity erosion seen across the real estate spectrum. Those owners with the highest-quality tenants, those anchored or backed by credit-rated retailers, will have the ability to refinance. However, owners with less favorable tenants may be forced to bring properties to market or invest additional equity. As that scenario plays out further this year, the increased supply of second-tier properties will become a focus for investors actively seeking higher yields. In fact, properties with franchisee and non investment-grade tenants yield 100 basis points to 200 basis points above corporate-backed assets.

The median price per square foot for single-tenant assets in Connecticut is anticipated to increase 11.8% by year's end to nearly $179 a s/f. As a result of this greater competition for credit-tenant, net-leased product, which offers long-term stability to both local and out-of-state investors, average cap rates are expected to drop 15 basis points to 8.16%. Shopping center investment sales also improved. The median price per s/f is expected to jump nearly 9% to $163.37, while the cap rate dropped 35 basis points.

Transaction activity in New Haven/Fairfield County will maintain a sustainable pace in 2012, as investors wait for quality, low-risk assets to come to market. The most sought after of these properties are located in Fairfield County, near I-95. Multi-tenant complexes with healthy anchor tenants, such as fitness centers or national grocery stores, will continue to grab investors' interest. Cap rates for these properties can range from 6% to 8%, depending on the size and location. Meanwhile, first-year returns for single-tenant assets can vary from the low 6% area to the mid 8% range. As redevelopment plans come to fruition in Fairfield County, developers will emerge to pursue properties with additional land for commercial use.

Seasoned, private local investors will account for most of the sales throughout Connecticut in 2012. These buyers often have a specific retailer in tow, or know the credibility of the current tenant mix at the given property.

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