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Buyers that have been sitting on the sidelines are beginning to take advantage of current market

April 21, 2009 - Spotlights

Investment Sales Market - Retail-Single Tenant Market

The recession is proving to be a significant challenge for most retailers, with many businesses shuttering locations in an attempt to contain costs. The single-tenant net lease retail sector is expected to register far fewer 1031-exchange transactions in 2009. This trend, which began to emerge in the second half of last year, stems primarily from the investors difficulty in trading out of more management-intensive assets and the stricter lending criteria in the marketplace. The shrinking pool of 1031-exchange buyers that are in the market have smaller exchange proceeds to invest and are ultimately looking for smaller assets for their upleg.

There has been an increase in high net worth buyers that have been sitting on the sidelines that are beginning to expand and diversify their real estate portfolio taking advantage of the current market conditions; attractive financing and higher cap rates. These same buyers have been shifting their investment allocation from stocks to real estate.

Drug Stores - Increased Inventory, Cap Rates Rising

The drugstore market continues to be dominated by its two largest participants. During the fourth quarter, CVS Caremark acquired Longs Drug Stores, as well as the company's pharmacy benefits management service, Rx America. The transaction makes CVS the largest drugstore chain in the US, with approximately 6,800 stores. Walgreens, the nation's second largest chain, at nearly 6,500 locations, has announced several initiatives intended to cut costs and strengthen its core business over the next several years.

The presence of these two major players, along with Wal-Mart's generic drug program, is making it difficult for Rite Aid to compete. A reduced number of 1031-exchange buyers in the marketplace this year will significantly affect drugstores.

Traditionally, investors have favored this property type due to the low risks typically associated with these assets; however, the nation's for-sale drugstore inventory has increased, as many buyers have not been swayed by average cap rates that have climbed past 7%. Although the majority of transactions contain corporate guarantees, sales velocity has dropped off and prices have dipped, trends that could continue through the next few quarters as constrained capital markets and fewer sales of other property types reduce the number of qualified buyers.

Quick-Service Restaurants - Fast-food not immune to Economic Downturn

While quick service restaurants will remain popular with investors, most buyers are exercising increased caution when selecting assets. As with many other property types, investors are favoring urban locations in primary markets where population density supports demand. As a result, quick service restaurants in secondary and tertiary markets or those in outlying submarkets are recording reduced investor interest, even as average cap rates have pushed up into the mid to high 7% range in recent quarters. One of the bright spots for this segment continues to be McDonald's. Corporate guaranteed McDonald's ground leases are still trading in the high 5 to low 6 CAP range.

Casual Dining Restaurants - More Home Cooked Meals a Concern

Investment activity in casual dining is expected to continue to cool as investors and lenders become more thorough in their review of the financials of tenants, franchisees and parent companies. Deals will still get done, as the asset class remains a buyer favorite due to its typically low price points and cap rates that are in the high - 7% range and creeping higher. Casual dining restaurants are especially hard-hit, as more individuals are opting for home-prepared meals in order to trim expenses. Given the current economic weakness, aggressive buyers seeking distressed properties may find a number of opportunities in casual dining restaurants.

Big Box - Woes for Electronics Retailers

Big Box electronics chains were some of the primary beneficiaries of the tremendous wealth that was created during the housing boom, as consumers spent equity to upgrade their homes. Sales have dropped off dramatically during the downturn, however, as evidenced by Circuit City announcing the closure of all of its nearly 700 US stores, a move that will result in approximately 15 million s/f of vacant space. Competitor Best Buy is still operating, but plummeting sales have caused the electronics giant to sharply reduce it profit forecast. Despite average cap rates rising into the high-7% low 8% range, sales velocity in the big-box sector is forecast to decelerate this year. Given the recent wave of big-box store closures, securing tenants for large blocks of space is going to be a significant challenge in a contracting economy. This difficulty is likely to drive away many buyers until signs of a turnaround emerge.

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