

RETAIL SERVICES

During the 2001 recession and jobless recovery of 2002 and 2003, consumer spending remained surprisingly resilient, supporting retail leasing and investor demand. The economic recovery will only increase consumer spending and retail leasing. Grocery-anchored centers will continue to offer strong cash flows and a safe position in any economy. However, investors should cast a wary eye on properties that are susceptible to competition from new super center and neighborhood market formats introduced by Wal-Mart and other discounters.

The retail property market is at the top of its game in terms of both leasing and investment, especially compared to the other three core property categories. Consumers have carried not only the retail market, but the entire economy through the recession of 2001 and the jobless recovery of 2002 and 2003. Business capital spending fell off a cliff in 2000 and has only recently begun to pull itself up from the bottom, draining demand for office space and, to a lesser extent, industrial space. Multi housing properties, which usually hold up well during a downturn, have been buffeted by mortgage rates at 40-year lows, which have drawn renters into the ownership market. This leaves retail properties, which largely were ignored by institutional buyers through most of the 1990s, at the top of investors' buy lists, particularly grocery anchored centers, which are considered recession-proof; everyone has to eat, as buyers are fond of reciting.

However, a more pertinent question is: are they Wal-Mart-proof? In addition, if they have survived the onslaught of the super center format, will they survive a second wave of Wal-Mart Neighborhood Markets, designed to capture the dollars of the traditional grocery store customer? So far, investors are betting that they will, particularly infill centers in developed trade areas that offer a measure of protection from competitors. Of all retail concepts, power centers have traveled the furthest the fastest in the hearts of investors. Thought to be susceptible to downsizing big-box retailers and Internet sales, power centers that have survived the big-box shakeout are now viewed as attractive candidates for acquisition, especially for investors unable to find suitable grocery-anchored properties. Malls have further bifurcated into the Class A fortress malls that are secure from competition and Class B and C malls that will require substantial dollars for renovation, redevelopment into open-air or Main Street formats, or demolition and reuse for residential or industrial development, depending on their trade area.

Unanchored strip centers, once thought to be terrible investment candidates due to their propensity for overbuilding, now present very favorable acquisition targets in gentrifying central and mid-city neighborhoods where household income is high and competition from other retailers is low. Similarly, the decades-long efforts of city planners and municipal governments to revitalize their downtowns is bearing fruit, not just in the 24-hour markets like Boston and San Francisco but in smaller, 24-hour wannabe markets like San Diego and Indianapolis. Investors can find mixed-use opportunities with street-level retail in both new and rehabbed buildings—a product type that may be particularly attractive to private buyers.

The retail property market is likely to get even stronger in the coming year. While some analysts suggest that spending will decline as the tax cuts and wave of mortgage refinancing pass into history, the majority view holds that spending will rise as the recovering economy puts more people to work, which will provide additional support for an already healthy property type.

Atlanta tops the list of retail markets that are likely to generate the strongest investment returns over the next five years, thanks to a rapidly growing household base. With the exception of Washington, DC, eight of the remaining markets in the top 10 list are in the West or Southwest (including Texas), indicating the importance of dynamic population growth to retailers. The US apartment market, like its office and industrial cousins displays the same disconnect between leasing and investment market conditions. While the leasing market deteriorated as 2003 progressed, investor demand remained as strong as ever. Now as 2005 progresses, the rising capital cost will bring the investor to their senses and the rental market back to the availability inventory.