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Halt in retail bodes well for the prepared

RETAIL: MORE ON PAGE 13

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BOCA RATON - There are now about 1,900 shopping centers greater than 45,000sf in size located throughout the major metropolitan areas of Florida. At least once a year, Woolbright's Research Group physically visits each of these projects. In addition to the field visits, throughout the year we track all of the sales, new construction, proposed projects and asking rental rates. We define the major metropolitan areas as Miami-Dade, Broward, Palm Beach, Orlando, Tampa/Pasco/Pinellas and Jacksonville.

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At present, based on our field work in late 2008, there is a total of 250 msf of shopping centers - excluding regional malls - in those areas, with 9.1% of the space currently vacant. While the vacancy has increased from the 2007 levels of 7.5%, and rents have fallen somewhat, by historical standards the Florida retail market is far from the dire levels it experienced in the early 1990s during the savings and loan crisis.

Nevertheless, we have crossed into previously uncharted territory with the collapse of the sales of properties and new construction.

The credit crunch that began mid-year 2007 triggered a rapid contraction in the expansion plans of anchor tenants, construction lenders, buyers and developers throughout the state and indeed the nation. Woolbright's survey of all active retail construction projects indicates that total retail deliveries for 2009 will be approximately 3.1 msf, and we will add only 22 new centers in the major metro areas statewide. While Tampa and Jacksonville halted most new construction starts in 2007, resulting in an opening shutdown in 2008, the remainder of the Florida's major metro areas shut down new starts a year later in 2008.

In 2009, the retail project openings in Florida's major metros will decline by about 62% as compared to the 2007 and 2008 levels. Florida's retail supply will grow at only about 1.2% in 2009, the lowest level on record. We forecast that the rate of growth will contract even further in 2010 and 2011 because far fewer projects will attract anchors or lenders in 2009, the essential ingredient for expansion. So, Florida will face a three- to five-year period with average retail property supply growth of only about 1%.

Existing centers benefit in recovery

The massive decline in new openings will eventually be advantageous to holders of quality existing centers in Florida's major metro areas. We anticipate vacancy to peak in late 2009 or early 2010 as the economy begins its recovery.

Vacancy rates, which reached their lowest levels on record in 2006, are presently rising by 1% to 2% annually in the primary markets. In Florida's major metros, vacancy rates now stand at their 15-year historic average of about 10%. As the recovery inevitably takes hold, retailers will start to expand once again. Those expansions will be forced into existing centers because there will be very few new projects coming online under the 1% per annum supply growth.

This will cause rents, which flattened for the first time in 10 years during 2009, to reverse course and return to their normal upward trajectory. Nevertheless, the market to attract new tenants will be fiercely competitive under the current conditions, and it will favor the most aggressive and proactive landlords.

2008 retail property sales

In 2008, the sales market for Florida's open-air shopping centers experienced an unprecedented massive slowdown in transaction volume as a result in the collapse of the CMBS market. Sales volumes fell by 70%, from nearly $3.5 billion in 2007 to just more than $1.0 billion in 2008. In 2007, 179 properties changed hands, but in 2008 only 46 sales occurred, resulting in an 80% drop in the physical number of properties sold.

Cap rates and price per square foot

Nevertheless, while there were much fewer than normal transactions for those properties that did sell, prices did not collapse in 2008. The average capitalization rate for shopping centers

■ See RETAIL, Page 19

sold in Florida's major metropolitan areas in 2008 was approximately 6.85%, which was just 50 basis points higher than the 2007 average of 6.35%. Moreover, capitalization rates were fairly stable throughout 2008. They began the year at about 6.5% in Q1 and slowly rose in the subsequent three quarters to 6.9%. With so few projects trading, the quality of the assets that closed increased and the price paid per square foot rose.

Market volume nearly halts in 2008

The relative pricing stability for Florida's open-air shopping centers during 2008 stands in stark contrast to the collapse in prices for CMBS bonds, REIT shares and all of the major stock market indexes. Over the last decade, roughly 10% of all shopping centers changed hands annually. In other words, owners held onto their properties for about 10 years on average.

This pattern was shattered in 2008 when only 44 of the 1,900 open-air shopping centers in Florida's major metropolitan areas were sold, representing just 2.3% of the total. At this rate, investors would only sell a project once every 43 years on average, an unsustainable level.

Outlook for values in 2009

Now in the early months of 2009, the markets have completely frozen, and there are virtually no transactions being completed except for a few "forced sales." A normally functioning market requires a willing seller, buyer and lender - none of whom seem to exist at present.

Many are referring to the combined stock market and CMBS market collapse as the perfect storm, a "force majeure." Market participants are struggling to value assets, because there are no real data points. Instead, many are resorting to "voodoo pricing models" by simply picking values out of the air, ignoring the historical pricing characteristics of the past three decades.

Thus, the exuberance of 2007 and early 2008 has quickly been replaced by irrationality, panic and fear. All markets eventually revert to the mean; lending volumes always recover, and all crises eventually end. Nevertheless, the precursor to any recovery in the real estate markets is the return of a fully functioning commercial property lending market. It will take at least two to three years for the lending markets to heal themselves. In the meantime, the great real estate bear market of 2009 and 2010 will produce the opportunities of a lifetime for those with the capital to seize upon them.

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