REAL ESTATE NEW JERSEY

Date: Monday, December 01, 2008
Location: NEW YORK, NY
Circulation (DMA): 11,758 (N/A)
Type (Frequency): Magazine (10Y)
Page: 31,32,34,35
Keyword: Metro Commercial

Praying For Retail

The 2009 consumer landscape is bleak, so look for conservatism to rule the market

By Alyson Grala
Associate Editor

The near-term prospects for the retail business aren't particularly rosy, with the financial markets' meltdown and the general economic weakness scaring consumers into hiding. The financial and real estate markets in the US are expected to bottom out in 2009 and flounder for much of 2010, with ongoing drops in property values, more foreclosures and delinquencies and a limping economy that will continue to crimp property cash flows and consumer spending.

Emerging Trends in Real Estate 2009, a joint report from the Urban Land Institute and PricewaterhouseCoopers LLP, predicts that commercial real estate will experience a rough and lengthy correction. And retail will be part of that bumpy ride.

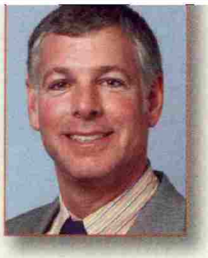
"We've all got to pray for retail," says Jonathan Miller, a consultant with ULI who also blogs for GlobeSt.com and is the report's principal author. "It's had a great run, but it's in for a tough time."

No less bleak is the National Association of Realtors' forecast, with chief economist Lawrence Yun predicting retail rent growth to turn negative in 2009, thanks in part to curbed consumer spending tied to unemployment and spiking food and energy costs. And any chance of new retail development is also expected to be hampered by a lack of financing.

"Although capital remains available for residential loans, the credit crunch is pronounced in commercial lending," he says. "Combined with a slowing economy, the lack of credit is curtailing activity in the commercial real estate sectors. As a result, there's been a slowdown in the net absorption of space, which is leading to higher vacancies and more modest rent growth."

According to NAR, vacancy rates in the retail sector are expected to be 10.4% in Q2 of '09, up from 9.75% in the second quarter of this year.

Adding further fuel to the recessive picture, the International Council of Shopping Centers' *Chain Store Sales Trends* revealed that October comparable-store sales declined 0.9% from October 2007 to October '08, the worst in 35 years. With the exception of Wal-Mart, whose sales rose 2%, the outlook



"Unfortunately, there's so much consumer debt out there, and if consumers aren't buying it's clearly going to be a problem."

JEFF LAGOWITZ
METRO COMMERCIAL

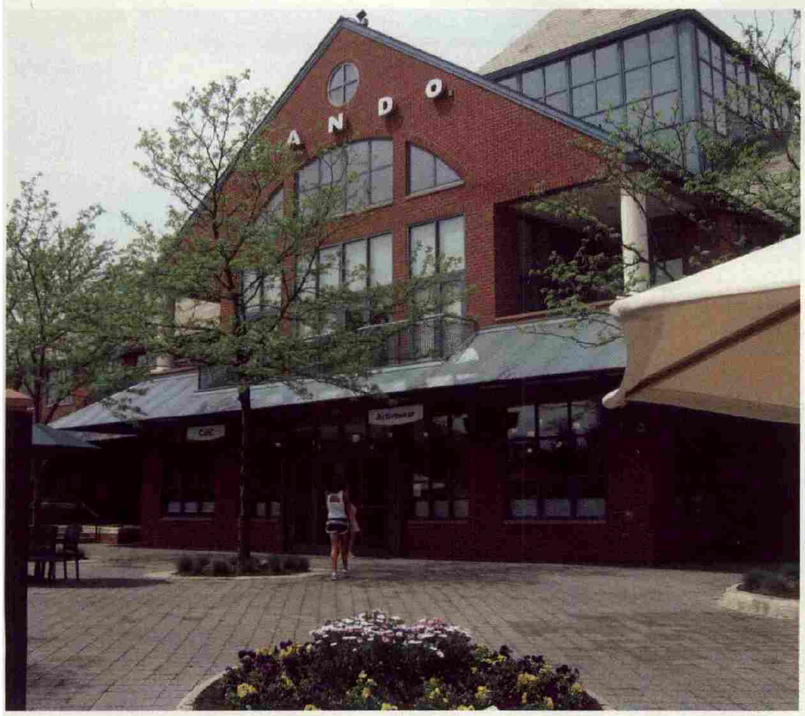
was less than rosy, and it does not bode well for the holidays. ICSC predicts same-store sales to be flat in November, and has lowered its holiday sales forecast to a 1% increase for the combined November-December period.

What does this mean for New Jersey, whose retail sector has traditionally been less affected by economic ups and downs?

"While New Jersey remains one of the strongest retail markets in the nation, with vacancy rates remaining relatively low compared to other segments of the real estate market, the retail segment can best be described as 'fragile'," says Scott Loventhal, director of development for Garden Commercial Properties in Short Hills. "Leasing activity has been sluggish during Q3 and Q4 of 2008 and will likely continue to slow during the first half of 2009 as fallout from the economy pushes more retailers to close or limit expansion."

"Nervous" is the word Cushman & Wakefield senior director Michael Stone, in that firm's Downtown Manhattan office, uses to describe the firm's outlook. "For now, we need to wait and see what happens after the holidays," he says. "Then we'll know which retailers are going to survive and which won't. We can expect to see the closing of underperforming stores. And you'll see retailers putting more money into revamping current properties rather than investing in new space."

To his point, Wal-Mart announced plans in late October to invest up to $1 billion in 2009 on store remodeling, while limiting new store openings. Stores will also be built smaller, ranging from 140,000 square feet to 170,000 square feet as opposed to the 200,000+-square-foot units of years past.



Levin Management is continuing its repositioning of Princeton Forrestal Center's retail component.

Reinvesting money into fewer, smaller stores is one thing, but there is also a string of stores that won't make it out of the recession intact (*see sidebar, page 35*). Linens 'n Things was liquidating its remaining locations at presstime, after filing for bankruptcy protection back in May.

Circuit City, meanwhile, announced in early November that it was shuttering 155 domestic stores, reducing future store openings and renegotiating certain leases–then subsequently filed for bankruptcy protection the following week. At presstime, the company was planning to engage landlords in negotiations to reduce rental rates in stores nationwide, which may prove difficult.

"Retailers will have a difficult time refinancing," says North Plainfield-based Levin Management's COO Matt Harding, referring to the broader scope of troubled retailers in general. "Lending institutions may even be getting some properties, particularly those that are on the market for sale."

"It's no secret that Circuit City has had a lot of problems," says Jeff Lagowitz, a partner at Metro Commercial in the firm's Fort Lee office. "The real question now is: How will this effect Best Buy? Are they the next to go, or is it the regional chains like PC Richard and Sixth Ave. Electronics? If sales are down in the entire category, then the chains that rely on major electronics purchases or household appliances are going to get hit pretty hard."

As for other struggling sectors, "expect to see home furnishings-heavy retailers continue to be hit hard," Hard-

"We expect to see retailers closing underperforming stores and revamping current properties rather than investing in new space."

MICHAEL STONE
CUSHMAN & WAKEFIELD

ing says. "Discretionary items will also continue to be impacted, and more upper-end retailers will feel the pinch as people continue to migrate toward value retailers."

"The discounters and wholesale clubs appear to be faring the best," Loventhal agrees, adding that poorly capitalized mom-and-pop retailers are having the most difficulties. But according to Lagowitz, there is a silver lining: "Maybe the useful life of some of these retailers is past. The strong survive and the weak go by the wayside."

Not only have retailers been shuttering underperforming storefronts, but there's also limited activity on the development front. "We attribute this as much to the difficult entitlement process and lack of available land as we do to the sluggish economy," Loventhal says.

Small shop expansion is extremely limited, he observes. Many small, local retailers rely on their own equity or SBA loans to expand, and the availability of these sources of financing has been limited. Although most national chains generally look further into the future and behind short-term economic conditions to determine expansion plans, some of those plans are being deferred.

"While the foundation of many of our regional shopping centers are the discount department stores, home improvement retailers, supermarkets and wholesale clubs, the small shop space remains an important component of our centers," Loventhal says. That said, one of his biggest concerns is that a prolonged economic downturn will lead to greater turnover rates at many of his company's centers, both old and new, which hurts the centers' vibrancy and economic bottom-line.

Harding, for one, feels that the banks need to ease up on their reluctance to lend. "While it's much harder to get leasing if your project isn't started, even pre-existing plans are in danger," he says. "I know of a retailer that has 20 deals signed for next year, but you have to wonder how many of those will be going forward."

According to Loventhal, vacancy rates will continue to rise as retailers deal with tighter credit markets and lower sales. He also expects to see cap rates rise since many potential investors have less access to financing, and uncertainty as to the credit worthiness of even some of the most recognizable names in retailing remains in question.

"Overall, 2009 will be a cautious year, with developers in general holding firm and watching the economy," Harding says. "I think the outlook will be better toward the end of 2009. With

On the Rebound: What Has to Happen

Emerging Trends in Real Estate 2009, a report issued jointly by the Urban Land Institute and PricewaterhouseCoopers LLP, includes a list of scenarios that need to take place before commercial real estate (including the retail sector) can effectively bounce back:

- Private real estate markets need to correct—lenders must force distressed owners to become motivated sellers.
- Debt capital needs to flow—lenders will need to learn to deal in a more stringent regulatory landscape. The CMBS market must "reformulate."
- Regulators need to restore confidence in the securities market. The government will insert itself into overseeing mortgage securitization markets. Systemic overhaul promises more measured debt flow.
- The economy needs to improve.

Best advice for 2009? *Emerging Trends* says:

- Investors should sit tight. Opportunities will surface at significant discounts.
- Buy discounted loans.
- Recap distressed borrowers—invest in maturity defaults, construction loans/bridge loans, or take mezzanine positions and equity stakes in properties.
- Invest in publicly held REITs—they will lead the market's recovery.
- Focus on global pathway markets, namely 24-hour coastal cities.
- Staff up asset managers, leasing pros and workout specialists, and separate good assets from bad.
- Retrench on development and reorient to mixed-use and infill. Higher-density residential with retail will gain favor in the next round of building.
- Go green—cutting energy expenses is likely to be a priority.
- Focus on neighborhood retail centers with strong grocery anchors and chain drugstores.

more tenants looking for expansion, some of the vacancies that occur after the holiday season will be absorbed. Even now, there are still regional and local tenants looking to expand. It's a long process, but there are still those out there who are strong and looking to take advantage of a down market."

One bright spot may be that Libor and many of the commercial lending rates have been coming down, and the actual cost of money, where available, to many commercial borrowers has been reduced.

And that, Loventhal says, "we hope will provide more opportunities for retailers and developers to continue to borrow and invest."

Looking ahead to '09, you can expect that the retail market will remain conservative.

"The residential market is having a hard time, which means that we'll see less mixed-use development, or we might see a shift in the type of mixed-use projects with newer versions featuring fewer residential offerings and more office, hotel and retail space," says Harding. He adds that Levin Management is handling the ongoing repositioning of the retail component at Princeton Forrestal Village, a combination of such a mix.

"Strip malls will always be popular in a car-based market like New Jersey because of the convenience factor they provide for daily needs, such as supermarkets and drug stores and the tenants that join them," Stone says.

"Alternative retail environments such as interior and exterior malls and downtowns satisfy a different customer need for community, entertainment and leisure," he continues. "And I don't think they are necessarily mutually exclusive. The good ones will continue to attract people."

Stone also sites the impending opening of the Meadowlands Xanadu retail/entertainment complex at the Meadowlands Sports Complex, which is belatedly slated to cut the ribbon in mid-summer of next year, as a potentially profitable destination and one of the more interesting retail events in New Jersey in the year ahead. Yes, there are critics of its "colorful" architecture, but it indeed figures to be a destination.

On balance, though, there are more questions than answers to the retail picture at this point. And there are too many larger factors impacting the industry to be able to clarify that picture any time soon. It's a scenario that figures to play out over months, perhaps even years.

"Unfortunately," Lagowitz concludes, "there's so much consumer debt out there. And if consumers aren't buying it's clearly going to be a problem." —RENJ

Safety in Numbers

The list of retailers filing for Chapter 11 has been growing and survivability is always the issue. That said, there's no question that the 2009 retail landscape could look decidedly different than it did just a year ago because of a combination of bankruptcies, consolidations or companies changing the way they do business.

But while companies seeking Chapter 11 protection are down, they're not always out of game. Using history as a benchmark, independent long-term survival beyond Chapter 11 isn't likely, but retailers like Federated Stores (Macy's), Southland (7-11) and Winn-Dixie have proven that it's not impossible. Here are just a few of the retailers—some now dissolved and some still struggling for a foothold—that have filed for Chapter 11 in the past year:

- Linens 'n Things
- Circuit City
- Boscov's Inc.
- Mervyn's
- Shoe Pavilion Inc.
- Sharper Image
- Goody's Family Clothing
- Fortunoff
- Wickes Furniture
- Dan River Inc.
- Mrs. Fields
- Value City Department Stores
- Domain Homes