retail acquisitions

Disciplined buying in an ever changing market

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Purchasing retail real estate has become a bit of an art rather than a science over the last 12 months. In order to be successful you must assess certain risk factors that will either make or break your portfolio. Three key factors have come into play in the northeast marketplace. First, the 100+ basis point rise in treasury notes has made the cost of capital more expensive. Second, the lag in adjustment of capitalization rates has caused compression in the market as treasury notes have increased 100 basis points, capitalization rates have only moved 25-40 basis points; thus causing the need for upside opportunities in deals to make up the difference. Lastly, the 1031 tax free exchange market has been consistently keeping capitalization rates low and keeping the expectations of sellers above where it should be. These factors are keeping numerous investors and funds with ample capital on the sidelines.

A statistic I found compelling-the July issue of Real Capital Analytics, in the Retail Capital Trends Monthly section, shows a 25% decrease in investment sales volume for retail properties on a national level for the first half of 2006 compared to the first half of 2005. Although the northeast is a strong market, because of the high barriers of entry and strong demographics, only Long Island and Manhattan have seen increases in volume. In contrast, the outer boroughs, Westchester, Fairfield county and northern N.J. have seen double digit decreases in sales volume. This drop is not indicative of a lack of demand, but rather a significant shortfall in supply. Although sales have been on a decline, cap rates and asking prices for deals have not changed to suit the market.

Assessment of risk needs to be extremely disciplined with new acquisitions. The following are certain points that should be considered when purchasing a property:

• Market placement. Does the property have good market placement? (geographically as well as demographically)

• Expected returns. What are the expected returns, short-term and long-term?

• Tenant Stability. Does the property have strong tenants (i.e. national or credit) that have lasting power in the market?

• Tenant Roster. Does the property have a good tenant mix which can help tenants succeed in a tough retail environment?

After addressing those initial points, you can then form a plan for implementation of goals and expectations. This is an important step because it can help avoid certain pitfalls and sudden problems with your property in the future. This step can also answer your question as to a proper time to implement an exit strategy.

After concluding your assessment of risk, mitigating what risk you can control is crucial to a lasting successful investment. An example of mitigating risk is approaching the investments you make with a set of goals and expectations. Each deal will have its own risk factors in which a set plan can help you navigate your way to your goals and avoid future issues. Balancing your portfolio into categories can be another example of risk mitigation. For example, I follow the school of thought of establishing two separate portfolios: one portfolio of defensive properties, which are stable assets that can produce a return, but have a ceiling in terms of upside. The second is a portfolio of opportunistic properties, which are risk reward types of properties that require lease up and have future upside potential. Establishing both sets of properties can create a balance of solid returns in good times and bad.

Although I cannot foresee the interest in retail real estate subsiding, I have seen a market that has become extremely segmented by price and expected rate of return. Different types of buyers have emerged and placed themselves in specific categories. We have seen the emergence of investment funds and REITS storm the $20 million and up market looking to place money in "class A" shopping centers. These properties pre 2002 were trading in the 9-10% cap rate range. As the Equity markets were somewhat of an unknown after the Internet "bubble burst," Wall Street and institutional equity dollars needed a stable place to invest, thus the retail real estate market heated up and became a focus of institutional investments. The other two major segments of the investment market are 1031 tax free exchange buyers, who need to invest their money in a certain timeframe and the regional investor who has been purchasing class "B" and "C" anchored and unanchored retail. These invest-ments have caused frenzy in the marketplace creating new development and significant growth.

I believe that if interest rates stabilize both buyers and sellers will become more attuned to realistic pricing, easing a transition from the uncertain period we have been in the last 12 months. Rate stabilization will keep the retail market active and money chasing deals.

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KATZ PROPERTIES
Real Estate Investments

LOOKING FOR ACQUISITIONS

Retail properties between $2,000,000 and $25,000,000

Investment Criteria – Convenience oriented Retail strip, neighborhood, community and regional shopping centers.

• Good market placement, infill locations
• Anchored, unanchored, local or regional tenant base

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