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SPECIAL REPORT Retail Guide 2010

RETAIL INVESTORS **BRACE FOR THE BOTTOM**

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Glance at most recent retail deals, and it's clear South Florida's retail sector is still in significant decline. The question is how low it will go and when it will hit bottom?

How pronounced is the slide? A few examples:

■ A company called The Forum at 44th paid $2.6 million on March 16 for Forum Plaza, a 46,902-square-foot center at 8530 NW 44th St., Sunrise. Less than three years ago, the property sold for $6.17 million, according to Broward County records.

■ Property owners are learning to rein in their value expectations. Shopping centers like the fully occupied Bird 74 Center in Miami have sold well-below initial asking prices. Seller Forty Properties sought about $5 million for the 7378 SW 40th St. center in June 2009, but buyer 2901 West Commercial negotiated the price to $4.45 million — an 11 percent discount — in early March.

■ Some developers are dumping properties through loan assumptions due to a lack of cash buyers. Grocery story chain Publix had the option to acquire a 2-year-old Boynton Beach shopping center for nearly $30 million. It declined. Instead, Tennessee investor PGM Properties acquired the property by assuming the $26.8 million loan from distressed developer Monroe Prestige Group.

"I don't think retail has bottomed out," said Michael Zimmerman, a Marcus & Millichap vice president.

Pinpointing the bottom is nearly impossible, he said, adding there won't be any turnaround until there's a boost in hiring by South Florida employers, and banks increase the number of loans they write off or step up foreclosure suits. That would lead to the resetting of property values.

LANDLORD OUTLOOK

Two recent reports signal a further erosion of the market.

In a CB Richard Ellis survey of 995 owners of South Florida retail properties, more than 71 percent predicted prices won't level off until the end of the year or into 2011. And more than 82 percent said lending won't return to previous levels until at least 2011.

Increasing vacancies, not scarce loans or declining values, is the most pressing concern for South Florida retail center owners, according to the CBRE survey.

Landlords — especially owners of grocery-anchored centers built within the past decade — are justified in fearing they will lose more tenants, according to Marcus & Millichap's 2010 annual retail report.

Newer centers are expected to be hurt most this year as higher rents negotiated during the boom years strain tenants and lead to more store closings.

Vacancy rates for grocery-anchored centers built after 2000 in Miami-Dade County ended 2009 in the mid-12 percent range and are expected to climb above 13 percent in 2010, according to the Marcus report. The vacancy rate for Broward County centers anchored by large food stores will also rise this year to the mid-12 percent range from about 11.5 percent last year. Palm Beach County vacancies are forecast to increase from about 12.5 percent last year to about 13 percent this year.

The first three months of 2010 did not bring any occupancy relief for landlords, according to the CoStar Group. South Florida retail vacancies increased from 6.8 percent in the fourth quarter of 2009 to 6.9 percent in the first quarter of 2010.

Rising vacancies led to a decline in rental rates, to an average of $20.61 per square foot in the first quarter, from $21.15 per square foot in the previous quarter and $21.85 per square foot a year earlier.

The quoted rents likely do not reflect what landlords are truly being paid by tenants, said Greg Masin, senior director of Cushman & Wakefield's retail division.

"The reality is a lot of people occupying space are not paying at their [quoted rents]," Masin said. "They are either not paying at all or are being coddled by their landlords, who are more worried about losing existing tenants than leasing new space."

Retail construction, much of it in the pipeline before the recession began, did not slow down during the downturn and has continued to push up the sector's vacancy rate, according to CoStar. More than 2.57 million square feet of space was built in South Florida in the past year, including 12 centers totaling 1.02 million square feet completed in the first quarter of 2010.

But only eight shopping centers totaling 150,658 are currently under construction. A significant fall off in construction could help occupancy levels rebound.

"There's not any more product being added to the market" once the remaining projects are finished, Masin said.

Before a bottom is reached and a recovery can begin, a broader economic rebound — including employment growth, a loosening of the capital markets and an increase in consumer confidence — must occur, Masin said.

"To a large extent the consumer still has its wallet in its pocket," Masin said of consumer behavior which is tied to the health of tenants and landlords.

MATURING DEBT

In the capital markets, the fallout from the residential lending crisis is still taking shape, Masin said. About $1 trillion in commercial real estate debt is due to mature between now and the end of 2013, according to a congressional panel.

Adding the maturing loans to a pile of bad loans banks are already sorting through means refinancing existing properties or obtaining loans for new acquisitions could be impossible.

"We're in the second inning of the game," Masin said. "With the lack of liquidity in the marketplace, will we see another mechanism created that allows real estate to be refinanced? Will banks [be willing to] take haircuts?"

The search for the bottom will mirror that of residential real estate, but the impact probably won't be as severe, said attorney Thomas Lehman, a partner at Levine Kellogg Lehman Schneider & Grossman.

Resolving the anticipated wave of retail foreclosures would be the first step in the sector's stabilization, Lehman said.

"If you want to find the bottom, it will be when retail property mortgages become a significant enough problem for banks that they go the route of Corus and have to sell their loans to investors," he said. "We're a long way away from that."

But "for retail, our [South Florida] banks haven't invested as heavily as in residential," Lehman said. "So there could be a softer landing" for bankers.

With the region filled with distressed real estate loans of all types, lenders are showing more of a willingness to work with retail property owners to avoid more foreclosures, said Warren Weiser, founder and chairman of Coral Gables-based Continental Real Estate Cos.

That's good news for tenants worried