2008 retail forecast: Some positive facts will buoy us through this period and prepare us for the future

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I am sure we can all agree that closing out 2007 was a relief. As we rang in a New Year at midnight-was your glass of champagne half empty or half full?

Opening the door to a new year we will want to regain a semblance of "normal," despite heading into a new part of the market cycle. While the current environment can create challenges and frustrations, we also need to recognize some positive facts will buoy us through this period and lay the foundation for the future.

Half Empty

Challenging economic news is all around us-retail sales are off, stock market is unstable, high gas and oil prices are impacting the consumer, unemployment is on the rise, among others. Three questions will dominate conversation in the near term.

First, what will be the outcome of the Centro Properties capital woes and what do the implications mean for the rest of the market? The industry will be monitoring the story closely, along with the parallel dramas surrounding Macklowe and Maguire Properties, looking for signs of where the market may be going.

Second, when will lenders settle down? Class B and C projects, secondary and tertiary markets and assets with "a story" are being rejected or priced conservatively. Lenders that are "in business" have the opportunity to be selective and are taking advantage of the situation. The inconsistency and lack of liquidity in the debt markets continues to be a major concern.

Third, how far will the gap spread between class A, B and C cap rates widen as a result of this pressure? With costs of capital rising, cap rates are sure to continue their trend upward. Investors seeking assets that are being underwritten with more scrutiny by lenders will need to adjust return expectations to keep leverage accretive.

Half Full

In spite of the negative market tones, plenty of equity remains designated for retail real estate. The challenging market conditions may have eliminated the "traders" and the true real estate players, who take a long-term perspective, are applauding.

In addition, the eternal optimists have a few market signals to point to. Retail real estate fundamentals are generally strong. With few exceptions, there has not been outrageous overbuilding which has sustained rents and kept occupancy at high levels. The health of commercial real estate is further supported looking at CMBS default rates which are below 0.50%.

However, lenders are going back to basics and the frothy lending environment is over. But, getting back to basics may be good for our industry. The re-instituted discipline may dampen the returns, but will provide for sound fundamentals for long term investment performance.

Despite the stricter underwriting criteria and uneven lending environment, the ten-year Treasury has

fallen below 4.0%-more than 130 basis points lower than the high last June and spreads appear to be stabilizing.

There are also pricing glimmers of hope-core properties are holding up. Class A deals that appeal to the low leverage/no leverage institutional players continue to price aggressively due to a continued lack of product to satisfy this demand.

Blending the two glasses together we can conclude that good quality assets in strong locations will continue to be sought by investors; lenders will be more prudent in their underwriting (remember this practice is, for the most part, good); and pricing should get closer to equilibrium between risk and reward. Expect volume to accelerate as the year gets underway and the capital markets (hopefully) settle down and facilitate a normal deal flow across the spectrum of property profiles.

So, no matter what is in your glass, best wishes for a happy, healthy and prosperous New Year.

Cheers.

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