COX CASTLE NICHOLSON

Retail Perspectives

2015 FORECAST

As we have done for the past six years, the Retail Group of Cox, Castle & Nicholson LLP has, once again, taken on the daunting task of forecasting what to expect in the forthcoming year in four critical segments that affect the retail industry. In doing so, we analyzed the social, political and economic events of 2014, reviewed various economic data and projections and have come to certain opinions relating to the retail industry and where it is heading in 2015. Below is the product of our thinking, in the form of four articles of interest addressing such topics as capital markets, retailing, retail development and the impacts of residential development on retail.

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HISTORICALLY LOW INTEREST RATES (AND OTHER POSITIVE ECONOMIC INDICATORS) FUEL RETAIL CAPITAL MARKETS IN 2015

By: Gary Glick

Despite the usual litany of obstacles, the U.S. economy closed out 2014 with its best momentum in 11 years. Real gross domestic product (GDP) grew at a 5% annualized pace in the third quarter, the strongest advance since 2003, as consumer and business spending accelerated. In addition, the surge in GDP occurred despite Federal Reserve Chair Janet Yellen's winding down of the Federal Reserve's monthly purchases of $85 billion in long term bonds, a program aimed at pumping money into the economy.

The Dow Industrial average ended 2014 with a 7.5 increase over 2013, its sixth annual gain in stocks since the financial-system crash of 2008. Investors' moves in 2014 were driven in large part by a bifurcated global economy: surprising strength in the U.S. while much of the rest of the world struggled. Diving oil prices in recent months helped re-energize Wall Street optimists. It also did not hurt that 2014 was one of the few recent years when the nation's capital was devoid of major budget fights and threats of a government shutdown.

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RETAIL STILL REBOUNDING IN 2015

By: Scott Grossfeld

As compared to the last few years, 2015 seems to be better positioned for a retail resurgence. Last year (2014) experienced (and as we predicted in last year's forecast) a bolstering of the core economic fundamentals that are the key to any retail recovery. Unemployment is down, inflation is in check, interest rates are low, consumer confidence is good and prices for staples (such as gas) are down or flat. For these and various other reasons, many believe that a retail recovery/comeback will continue in earnest throughout 2015.

The positive outcome of the 2014 holiday season will undoubtedly create good momentum for retail moving into 2015. Although many retailers and analysts were initially concerned that retail sales over the "Black Friday" weekend were projected to be down by as much as 11% as compared to the previous year, according to the National Retail Federation, retail sales over the full 2014 holiday season appear to have increased by approximately 4.1% to 4.2%.

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RETAIL DEVELOPMENT - SLOW BUT STEADY WINS THE RACE

By: Dan Villalpando

The retail industry welcomed 2015 with cautious optimism, not unlike the sentiment from the previous year. After years of relative stagnation commencing in 2008, experts believe that retail development took a step forward in 2014. Based on some positive news regarding the gross domestic product, continued growth in the job sector, and the potential for an influx of foreign capital, it appears as if there may be reason to expect continued improvement in retail development this coming year.

One facet of the economy which has a major influence on the health of retail development is the gross domestic product (GDP). The latest data indicates that the weak growth rates in the GDP of 2009-14 that stagnated around 2% may be a thing of the past, as experts forecast growth of 3.1% in both 2015 and 2016. According to the UCLA Anderson Forecast of December, 2014, such growth will "bring a sense of economic progress on Main Street, which is a feeling not necessarily brought on by the tripling of stock prices since the lows of March 2009".

Moreover, while housing starts have been slightly lower than expected, the unemployment rate continues to fall, further infusing cash into the pockets of many households. As of November 2014, there were 2.7 million more jobs in the United States than at the end of 2013, which represents more job growth in 11 months than in any full calendar year since 1999. And, according to some calculations, the number of job openings is at the highest level since 2001, which signifies that job growth is likely to remain strong for the next several quarters. This news, coupled with wage gains (the Department of Labor estimates that private sector wages have been increasing at a 3% pace over the last six months), indicates that more people will have jobs, and those jobs will, on average, be paying more in the coming year. This should provide a boost to consumer spending, a critical element to retail development.

Consumer spending may also be bolstered by lowering gas prices. The price of oil has recently dropped by $50/barrel, lowering the price of gas across the country. Based on data from the Federal Highway Administration, analysts predict that the drop in gas prices could result in a $165.8 billion reduction in the price paid by Americans for gas in 2015 as compared to 2014, which money can be spent on other goods and services – additional good news for the retail sector.

The availability of financing is another shift in the marketplace that may result in more ground up development, and re-development and re-structuring of existing retail assets. Since the financial crisis of 2008, banks have been mostly wary of making loans secured by real estate projects (and not just retail). However, it appears as if commercial banks and other lending institutions are now looking favorably at real estate again. In addition, many experts predict a continued resurgence in commercial mortgage-backed securities which should result in more money "getting into the game". According to data from the Urban Land Institute, issuance of CMBS loans was expected to reach $92 billion in 2014 and is predicted to climb to $110 billion in each of 2015 and 2016. The comparatively weak return from Treasuries has also made real estate a more attractive investment option.

In addition, retail real estate investment is beginning to attract influx in capital in the form of "crowdfunding", which is the pooling of small sums of money online so that investors can acquire a share in a product, in this case a retail real estate asset. According to the UCLA Ziman Center for Real Estate, crowdfunding was projected to grow to approximately $10 billion globally in 2014, up from about $1.5 billion in 2011. Moreover, analysts report that the U.S. market is becoming more important to international investors seeking diversification and solid returns. According to Jones Lang LaSalle, foreign investors directed approximately $5.5 billion into 134 major property purchases in 2014, a 6% increase year to year. Many predict that such an influx in capital will help drive up prices for retail properties.

While there are some positive signs, there remain potential risks to the U.S. economy in general and, by extension, to the retail industry. As the economy accelerates, the Federal Reserve may initiate a period of higher interest rates, perhaps as early as the second quarter of 2015. That would mark the first time that the Federal Reserve has raised interest rates since 2006. Such an increase could cause businesses (both developers and retailers) to pull back, or at least put expansion on hold, until they can better grasp the changing economic environment. In addition, fears of a worsening global environment persist. If economic conditions outside the U.S. deteriorate, domestic economic growth could be adversely affected. However, these issues remain speculative in nature, and, at the current time, serve more as something for businesses to note, rather than to expect imminently.

In terms of what is occurring with different types of retail projects, reports of the demise of the traditional regional mall appear to have been at least slightly exaggerated. However, the strongest performing regional malls still tend to be located in more affluent trade areas. And owners of regional malls certainly have had to adapt to stay relevant. For example, as the public continues the trend toward healthier food selections and different types of cuisine, mall owners have been forced to rethink their food courts through general upgrades in quality and the introduction of more "exciting" restaurant concepts. In addition, regional mall owners have started to follow the trend of power centers by introducing sit-down restaurants and entertainment and internet experiences to make the mall more of an experiential venue where customers can shop, dine, socialize and be entertained.

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HOUSING MARKET - FROM REBOUND TO THE NEW NORMAL

By: Dennis Wu

Given the dramatic deceleration of gains in average home sales prices in 2014 nationwide, and the anticipated continued slowdown in growth during 2015, the housing market's period of rapid recovery after the Great Recession appears to be transitioning into a period of slower, but more stable growth, commonly referred to by economists as the "new normal."

Home prices are clearly increasing and will likely continue to increase into 2015, but at a much slower rate. According to data from Case-Shiller's Home Price Index, national home sales prices had a year-over-year growth of 4.8% in September 2014 and 4.5% in October 2014, compared to the double digit gains of up to 10.9% seen during the home-buying frenzy by investors and other home buyers in 2013 and early 2014. Although price gains are projected to continue at a slower pace in 2015 (with Realtor.com predicting home price gains as low as 4% and Zillow predicting home price gains even lower at 2.5% in 2015), many believe that the residential real estate market is finally returning to the basic principles of supply and demand. Further, with a decrease in sales of distressed properties and foreclosures, the composition of properties being sold will also be more "normal", as reported in a Realtor.com article dated December 4, 2014.

According to the Urban Land Institute/Price Waterhouse Coopers' Emerging Trends in Real Estate® 2015, "[a] health story is shaping up, whereby housing should anticipate moderate price increases, solidly based on buyers' ability to pay, fluctuating in a fairly narrow band along with minor ups and downs in the NAR's existing-home sales figures. It is a healthy – if boring – story. But after the thrill ride of the past decade in housing, boring is a very, very good trend to report." Trulia also reported in its December 3, 2014 article that while the "rebound effect drove the recovery" during the early years after the Great Recession, the housing market is now shifting to "slower, more sustainable price increases and a healthier mix of home sales."

In addition to more stable growth in home sales prices and improvement in the quality of homes being sold, some economists also believe that 2015 will mark the return of first-time home buyers, particularly Millennials (35 years old or less) who have largely been absent from the housing market over the past five years due to poor job prospects, strict mortgage-qualification standards and rising student debt. Although the problems associated with high student indebtedness have not improved for Millennials, improvements in job prospects and wage growth, the gradual loosening of strict mortgage standards, continued historically low interest rates, increasing rental rates and an overall decrease in the number of investors competing with buyers for single-family homes (as a result of the decrease in the number of bargains available to those investors) have all contributed to this developing trend. Stan Humphries, chief economist at Zillow, predicts that by the end of 2015, Millennials will surpass members of Generation X (those between the ages of 35 and 50) as the largest group of homebuyers in the U.S., as reported in a December 18, 2014 articles from Forbes. Jonathan Smoke, chief economist at Realtor.com, predicts that new-home sales will increase by 25% in 2015 from their current rate of approximately 440,000 for 2014, while the National Association of Home Builders (NAHB) predicts a 28% increase in new-home sales in 2015, as reported in a December 4, 2014 Wall Street Journal article. Although construction starts for single-family homes did not improve as much as experts had expected for 2014, Mr. Smoke predicts a 21% gain in construction starts of single-family homes in 2015 to accommodate for the increase in new-home sales, while the NAHB's Housing and Interest Rate Forecast predicts construction starts for single-family homes to increase by 25% in 2015.

Multi-family housing development remains the strongest of all housing sectors for 2015. The National Association of Realtors (NAR) has projected rent growth to reach 3.9% in 2015, compared to 4% in 2014, while Zillow has predicted rent growth to reach 3.5%. In addition, according to the Consumer Price Index, the annual rental inflation is nearly double the overall rate of inflation, allowing for landlords to demand higher rents. The NAR also expects the vacancy rate for rental apartments to remain low for the next two years, with vacancy rates projected to be 4.1% in 2015 and 4.2% in 2016, only slightly higher than the vacancy rate of 4% in the fourth-quarter of 2014. Driven in part by the foregoing factors, construction of multi-family housing is booming, with construction of apartments and condominiums returning to pre-boom-and-bust levels in 2014, as reported in a January 2015 Kiplinger article. According to the U.S. Department of Commerce and UCLA Anderson Forecast data, multi-family housing starts have dramatically increased from a little over 100,000 units in 2010 to over 400,000 units in 2014, and the increase in construction starts for multi-family housing is projected to increase further in 2015. Therefore, the multi-family housing market is expected to continue to see marked improvement into 2015.

However, while the outlook for 2015 appears generally positive, there are still a few challenges that may hinder the housing market's recovery. Specifically, while housing prices are improving at a more reasonable rate, home ownership will likely become less affordable in 2015. Jed Kolko, chief economist at Trulia, predicts that "[e]ven though prices won't rise as fast next year as they did this year, they will probably rise faster than ..incomes."

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HISTORICALLY LOW INTEREST RATES (AND OTHER POSITIVE ECONOMIC INDICATORS) FUEL RETAIL CAPITAL MARKETS IN 2015

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By: Gary Glick

On the employment front, in 2014 the labor market created more than 200,000 net new jobs per month for 11 straight months, the best streak since the 1980s. The nation's unemployment rate fell to 5.6% in December. The latest jobless figure is down from 6.7% a year earlier and the lowest since June 2008. However, the robust year of job growth may be deceiving, since many workers stopped looking for work, and wage growth for all of 2014 was largely stagnant. The lack of real wage growth may, unfortunately, restrain the ability of many U.S. households to elevate their living standards, underscoring a continuing feeling of malaise about the economy among Americans seen in many polls.

In 2014, instead of interest rates rising to reflect an ending of the Fed's quantitative easing program, long term Treasury yields actually fell. Experts have speculated that the decline in Treasury yields is likely due to a mixture of geopolitical, technical and fundamental factors, with the most significant factors being excess global savings and weaker than expected global economic growth. Most experts believe that long term Treasury yields in 2015 will continue to remain low, even as they predict that shorter term Treasury yields will move higher.

When the 153 members of The Wall Street Journal CEO Council were recently asked if they were positive or negative about the economy in 2015, 80% of their responses were classified as "very optimistic." Brain Cornell, CEO of Target Corp. stated: "Lower gas prices, higher employment rates and stronger consumer confidence should boost the consumer marketplace." There is "traction in middle class incomes," stated Gerry Lopez, CEO of AMC Entertainment Holdings Inc. "Lower energy costs do provide a sense that the gains may be sustainable. For the first time in six-plus years it seems we're focused on growth, not on sputtering around waiting for some indicator or another." "Momentum, even a little, fuels momentum," added Eric Elliott, CEO of Prime Therapeutics LLC, a prescription-drug benefit company.

The retail property sector generally is closely aligned with the overall health of the U.S. economy, due to the fact that more than two-thirds of United States GDP is comprised of consumer spending, much of it in retail establishments. In spite of healthy job gains in 2014, retail sales were solid but not outstanding. The two primary reasons cited by industry experts are meager real wage growth and an unwillingness on the part of the consumer sector to re-leverage despite very low interest rates. As a result, most consumers have remained modest spenders – cautious and selective – demonstrating why bargain/discount store formats continue to perform well. At the other end of the spectrum, luxury retailers have done very well in the U.S., although there are some concerns based on falling consumer demand in emerging markets and Europe. In contrast, mid-market retailers – especially department stores like JC Penney, Sears, and Macy's in traditional malls – are underperforming and, in some cases, present credit risks to retail center landlords and lenders. Alongside shifts in generational shopping and socializing habits, many commentators point to e-commerce as a major reason for this. Although internet sales currently account for just 7% of retail sales (excluding auto), they have seen rapid growth in recent years. However, many retailers are adapting well to the increased competition from e-commerce. Along with the development and enhancement of their own on-line presence (i.e., so-called "multi-channel retailing") and customer service, some merchants are moving to smaller store formats that can be used, in part, as showrooms. Retail developers also are adapting by altering the mix of tenants in their shopping centers to offer a great number of restaurants, health clubs and health providers, and "entertainment" and "experiential" retailers; services that cannot be duplicated easily over the internet.

Although most commentators expect the retail industry to continue to incrementally improve in 2015, the construction of new retail sites likely will remain substantially dormant but for new construction in certain core markets, mixed-use or primarily multi-family sites and in-fill locations. A continued movement toward the "work-live-play" environment often favored by millennials and baby boomer retirees will likely drive more new retail development in downtown urban areas in both large and small cities.

As has been the case each year since 2008, investment sales were once again very strong in 2014 due to historically low interest rates and the lack of opportunity for new retail construction.

As stated in 2015 Emerging Trends in Real Estate (published by the Urban Land Institute and the accounting and consulting firm pwc) ("Emerging Trends"), "there is more capital looking to buy than there are opportunities. The prevailing sentiment is the need to maintain rationality, to avoid getting caught up in the flood of capital being pushed by the tide rather than using it to best advantage. That requires considerable discipline. One prominent retail property executive stressed that 'abundant capital does not equal undisciplined capital for the year or two ahead.' He is encouaged that 'there is more skin in the game' through the capital stack, from lower LTVs [loan-to-values] to greater lender reserve requirements.'"

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HISTORICALLY LOW INTEREST RATES (AND OTHER POSITIVE ECONOMIC INDICATORS) FUEL RETAIL CAPITAL MARKETS IN 2015

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By: Gary Glick

The preferred retail product for investment remains the neighborhood and community center, much more so than regional malls or power centers. These centers have less exposure to cap-rate expansion than other retail types. Well-positioned neighborhood and community centers are still commanding cap rates in the 4 to 6% range. However, as was the case in 2013, with vast amounts of capital chasing "return", and with fewer and fewer "core" properties available, more and more capital continues to flow into secondary markets and, in some cases, tertiary markets where centers present "value-add" opportunities.

On the debt side, commercial banks have substantially finished their deleveraging and the restructuring of their legacy loans. This is especially true of the largest institutions, though regional and local banks still need to unwind some of their distressed assets. According to Emerging Trends, "[b]anking profits have risen, with banking net income at $40.24 billion in the second quarter of 2014, representing the second-highest performance for the sector in the past 23 years. Rising loan volumes and lower loan loss set-asides helped banks bolster their bottom lines."

Most commentators expect commercial banks to continue to remain quite active in 2015. However, pundits are interested to see if the new "risk-based capital requirements" will constrain lending. Much like in 2014, typical loan-to-value ratios for bank permanent loans likely will range from 50% to 70%. Terms likely will be short – typically in the 5 to 10 year range with amortization over 30 years, and interest rates are expected to be in the vicinity of 1.5 to 2 basis points over the 10 year Treasury yield. Banks also are expected to continue to make construction loans to preferred sponsors with development deals in primary and select secondary markets. However, significant pre-leasing will be required. These construction loans likely will be short term (i.e., 3 to 5 years), require significant equity (20 to 40%), be recourse obligations of the borrower, and have interest rates in the vicinity of LIBOR plus 3%, with a "floor" in the neighborhood of 5%.

Life insurance companies remain the most disciplined real estate lenders, and are not constrained by many of the new regulations on commercial banks. In recent years they tended to dole out between $50 billion to $60 billion in real estate loans. Life companies tend to have their pick of projects, and only lend to strong sponsors with well-leased properties. These companies are portfolio lenders and, while they care about interest rate risk, are more inclined to look at performance to maturity than nominal swings in prices implied by bond market volatility.

Life company loans likely will continue to be predominantly permanent loans with terms between 5 and 10 years and loan-to-value ratios in the vicinity of 65%. They likely will be non-recourse loans with fixed interest rates between 4% and 6%, and with amortizations between 25 to 30 years. It is anticipated that life companies will continue to confine their lending to Class A assets. However, like other lenders, life companies are forming club investment vehicles to access larger deals, so they can compete with public market players for high-quality property loans.

According to Emerging Trends, "U.S. CMBS volume was $86.1 billion in 2013, and had hit $68.6 billion by late September 2014. So $90 billion for full-year 2014 could be achievable, and an expectation for at least $100 billion in 2015 is the conservative consensus." Competition in this sector has certainly been increasing, and there are 40 or more originators supplying product. However, many industry insiders fear that the rating agencies have been too successful in avoiding serious regulatory reform since the 2008 financial crisis. As a result, they fret that CMBS is once again pushing the envelope, taking deals that the banks and life companies will not accept.

Most industry insiders believe that the current and near future environment for capital makes the opportunities for mezzanine debt rather limited. They believe there is too much money flowing into commercial real estate to allow the providers of mezzanine debt to achieve reasonable yields. This is not to say that there will be no mezzanine debt, just that it is expected to be significantly constrained.

The demand for debt capital could remain strong enough for opportunities to proliferate in the so-called "shadow" banking industry. Shadow banking refers to the financial intermediaries involved in facilitating the creation of credit across the global financial system, but whose members are not subject to the regulatory oversight required of banks. Shadow banking is considered an inevitable response to concerted efforts by regulators to constrain a wide range of operations by financial institutions. While its size is difficult to estimate, the shadow banking market caters to direct borrowers whose capital needs are not being met by traditional lenders. A growing number of private equity funds, REITs, and other shadow banking entities likely will continue to step forward to meet the demand for capital that is expected to grow in 2015.

2014 was the first year since this century's Great Recession where almost all leading economic indicators finally pointed to a robust economic recovery in the United States. Some of this good economic news has spilled over into certain facets of the retail industry – most certainly into the capital markets taking advantage of historically low term interest rates. However, despite all the positive economic news, it remains to be seen

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if 2015 will be a repeat of 2014 or better. Continuing economic turmoil in the Eurozone, wars in the Middle East, a government shut-down or some other crisis could derail this momentum. In addition, the retail industry, despite many positive signs, still has a very long way to go before the number of new centers built in California comes anywhere near the output prior to 2008. However, capital likely will remain plentiful in 2015 so long as historically low interest rates continue. This capital is expected to fuel refinancings, asset repositionings, investment sales, and new retail development in in-fill locations, urban mixed use projects, and areas minimally impacted by the Great Recession (e.g., Silicon Valley) where new housing starts continue to proliferate.

RETAIL STILL REBOUNDING IN 2015

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By: Scott Grossfeld

In the past, many economists and statisticians focused on Black Friday (or Black Friday weekend) as the period which would determine whether or not a retail year or holiday season was successful. However, this year it became more clear that changes in the manner in which business is conducted and changes in retail consumer behavior have resulted in a new quantifier for calculating holiday season sales. Instead of a single day or weekend being the bellweather for holiday sales, economists and statisticians are increasingly measuring holiday season sales over an expanded and lengthier period of time.

According to National Retail Federation President and CEO Matthew Shay, "[a] strengthening economy that changes consumers' reliance on deep discounts, a highly competitive environment, early promotions and the ability to shop 24/7 online all contributed to the shift witnessed this weekend. We are witnessing an evolutionary change in holiday shopping by both consumers and retailers, and expect this trend to continue in the years ahead." When rationalizing the drop in Black Friday period sales, combined with a rise in overall holiday period sales, National Retail Federation Senior Vice President Bill Thorne said "[w]e believe the drop in consumer spending was not a matter of consumers pulling back, but consumers responding to a much longer, heavily promoted and discounted holiday spending season that begins almost as soon as the Halloween costumes are returned to the attic. Consumer spending for holiday gifts starts earlier and ends later as the post-recession consumer seeks the best deals at the price point they want to pay. Further, as mobile use continues to grow and on-line retailers become more competitive, the need to fight crowds in order to get the best deals becomes less important."

Accordingly, whereas in prior years the outcome of the Black Friday weekend was highly indicative of the retail outcome of the year and the retail momentum going into the next year, today one really needs to look at the entire period from November through January to determine how well the true holiday retail season performs.

In the case of 2014, the holiday season performed in excess of expectations and this momentum will, hopefully, carry forward into 2015. In addition to the overall holiday statistics mentioned above, according to Swampscott, Massachusetts-based Retail Metrics, Inc., same-store sales for retailers rose 5.2% in November (excluding results from drugstores) and 2.9% in December – in each case, exceeding expectations.

Many commentators have attributed this growth to the fact that retailers offered holiday deals earlier in 2014 than previous years, while gas prices and unemployment and were at their lowest levels, and consumer confidence was at (or near) its highest level, since the "Great Recession" of a few years ago.

With strong momentum from the 2014 holiday season, many feel that retail could see the most pronounced improvement of all of the commercial categories since the Great Recession. According to Reis, Inc. in a January 6, 2015 Reuters article, the "accelerating pace of job creation, wage growth, and cheaper energy prices portend better times ahead. While we are still a number of years away from characterizing the real estate environment as 'strong', 2015 could certainly be a year of transition to a healthier market environment".

Many other commentators and economists seem to agree. Although 2015 may not ultimately be a break-out year, 2015 certainly appears to be at least a year of continuation, if not improvement for the retail industry. The reasoning seems to be the same. According to a December 24, 2014 Inside Real Estate article, "[i]mproving commercial property fundamentals, a steady stream of offshore capital and an accommodating Federal Reserve interest rate policy will sustain robust property investment in 2015, real estate analysts predict, as buyers keep seeking yield and safe

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RETAIL STILL REBOUNDING IN 2015

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havens in the U.S." In addition, according to a recent Property Wire article, "[t]he latest NAR quarterly commercial real estate forecast says that commercial activity should progress at a gradual pace heading into 2015. . . . Job growth is the catalyst to improved demand for commercial real estate leasing and new construction projects." According to the Property Wire article, commentators forecast retail vacancy decreases, increases in absorption and rental increases in retail for 2015.

Finally, according to a January 5, 2015 Shopping Center Business article, "[t]hanks to a positive economic outlook for 2015 driven by jobs growth and a sharp drop in gas prices, we are looking at high street markets to continue to grow next year. With the U.S. economy in recovery mode, confidence has increased and banks' confidence has increased, which has led to loans being given more freely. That translates to a healthy rebound of the ability to finance – whether you're in the QSR [quick serve restaurant] world or the apparel world. The U.S. economy created 2 million-plus jobs in the first nine months of the year, and near 10 million since the beginning of 2010, according to the Bureau of Labor Statistics, with gains expected to continue – even intensify – through 2015. A secondary factor is the sharp drop in gas prices, which puts more money in consumers' pockets. This has contributed 4% as of September, year-over-year growth in retail sales according to the U.S. Census Bureau."

However, there are also reasons to be bearish. Interest rates are likely to increase at some point, and that increase (or the expectation of that increase) may negatively affect the economy. New home starts have not been as robust as desired, resulting in minimal development of new retail projects. Many major retailers have resisted opening new stores, in part, due to the impact of e-commerce on the market. In addition, fuel prices may fluctuate and create nasty and confusing ripples within the marketplace.

On balance, though, it is generally thought that 2015 is poised to be a positive retail year.

So much so, in fact, that according to a December 4, 2014 ICSC Shopping Centers Today article, retailers are expected to open about 40,000 new U.S. stores between November 2014 and November 2015 – a 1.2% increase in store openings planned, as compared to 2013. Planned openings appear to be primarily in men's apparel, fast food, supermarkets, various international retail operators and a host of new Wal-Mart stores. Stores that are experiential in nature are also expected drive new store openings in 2015. These are stores that are less prone to competition from the internet – such as food users, health clubs and entertainment uses.

* * *

Though no one can be certain, it appears from the data and prior history that 2015 is lining up to be a positive year for retail. Unfortunately, it may not be that 2015 will get us back to the boom time prior to the Great Recession; however, we should continue to make progress.

RETAIL DEVELOPMENT - SLOW BUT STEADY WINS THE RACE

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By: Dan Villalpando

In addition, some regional mall owners are updating the interiors of their malls to try to mimic the feel of the outdoors, without losing any of the comforts of being indoors. For example, in some of its indoor regional malls, Westfield has begun experimenting with "SunBeamers," which distribute natural sunlight throughout an enclosed mall. Another change is the introduction of new or additional parking stalls for electric vehicles. Since research has shown that customers with electric vehicles tend to spend about 50% more time at the mall than their counterparts with traditional gas powered cars, in many cases it behooves the owner of a regional mall to provide additional electric parking stalls to try to keep customers at the mall as long as possible.

Grocery-anchored neighborhood centers generally continue to provide a good return for their owners. One of the larger growth sectors in retail is specialty grocers, such as Whole Foods, Trader Joe's and Sprouts, as well as discount grocers, like Walmart Neighborhood Market. And, although there is some uncertainly involving the consolidation between large scale grocers Vons and Albertsons, owners of neighborhood centers continue to be able to attract retailers eager to feed off of the foot traffic generated by a tenant mix that typically includes a grocery store and drug store.

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RETAIL DEVELOPMENT - SLOW BUT STEADY WINS THE RACE

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Other retail developers are being more proactive evaluating existing space by negotiating early lease terminations. These developers are seeking to strategically take back certain spaces prior to the natural expiration of the applicable leases in order to remerchandise those locations with better tenants and higher rents. Some "mid-box" or "junior anchor" tenants like PetSmart and Old Navy, who are looking to downsize their footprints, may be willing to give space back early to their landlords, who can look to aggregate enough square footage to attract certain "hot" retailers in an effort to revitalize their shopping centers.

Of the types of tenants that retail developers may target, analysts predict that men's apparel is likely to see the greatest jump in store openings in 2015. For example, Men's Wearhouse has announced plans to open the first flagship stores of its upscale Joseph Abboud brand this spring. In addition, despite a trend in some markets towards healthier eating, fast food continues to be a growing category, with pizza and burger restaurants devouring much of the available restaurant space. And Starbucks plans to continue growing in the coming year, rolling out a new 15,000 square foot Starbucks Reserve Roastery and Tasting Room concept, as well as an "express" shop that concentrates on mobile orders and a digital-pay platform.

In the coming year, retail developers will continue to deal with the challenges brought about by the Internet and e-commerce. Developers are being forced to work more closely with their tenants to ensure that the space provided is not only physically desirable, but also accessible to mobile devices by improving in-store Wi-Fi capability. However, Developers are starting to see somewhat of a paradigm shift as some traditional online retailers have begun leasing brick and mortar space for the first time. For example, Zappos.com recently launched a 20,000 square foot retail store in Las Vegas, and Amazon.com will also be opening a store in New York City in the near future. In addition, some traditional shopping center retailers plan on fostering a more cooperative relationship with online retailers by providing back room space for products to be stored so that customers can pick up their products the same day that they are ordered. Such retailers will benefit by allowing customers access to sizes and styles in the "cloud" that are not available in the physical store, but can be delivered from off-site warehouses.

When it comes to the world of retail development, the undercurrent of optimism from the beginning of 2014 continues to swell. While the needle on ground-up shopping center development may still not be moving, a solid uptick in the GDP, continued growth in the job sector, and the potential for an influx of capital, both from overseas and from here in the U.S. (in the form of both traditional capital and new sources, such as crowdfunding), bodes well for an improved year for retail developers in 2015.

HOUSING MARKET - FROM REBOUND TO THE NEW NORMAL

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By: Dennis Wu

Realtor.com also predicts that affordability of home ownership will decrease by as much as 5% to 10% in 2015. In addition, the mounting student loan debt, upwards of $1.2 trillion as of October 2014, continues to pose as a significant challenge for Millennials and their ability to purchase real estate.

Some experts, including the Mortgage Bankers Association, predict that 30-year mortgage interest rates could increase to 5% by the end of 2015. However, the same prediction was made for 2014, but the interest rate ended at an average of 3.87% by the end of 2014. If there is in fact a significant increase in mortgage interest rates in 2015, the affordability of homes would also be negatively impacted and any such interest rate increase could potentially hinder the recovery of the residential real estate market.

Consistent with the national trend, the California Association of Realtors (CAR) has also predicted a slowdown in price gains for California homes in 2015 as more houses become available on the market and fewer investors acquire them. These conditions will likely lead to a more balanced housing market in 2015 where prices should track more closely with the realities of the market. In addition, the CAR also predicts increases in existing home sales of 5.8% in 2015, while existing home sales decreased by 8.2% in 2014 from the prior year.

Although the housing market has transitioned away from the days of rapid growth, driven largely by an overcorrection after the end of the Great Recession, the recovery continues at a slower, but more sustainable and balanced pace. While most are still careful to avoid becoming overly optimistic, many homebuilders are regaining their confidence in the housing market. David Crow, Chief Economist at the NAHB stated: "[s]ingle-family builders are feeling good. They are not overly confident, but confident enough to keep moving forward." With steady improvements in all sectors of the housing market and overall confidence among builders and consumers, increased retail spending and development should naturally follow.

THE TEAM

The Retail Group of Cox, Castle & Nicholson LLP has extensive experience in acquiring, developing, constructing, leasing, financing, and disposing of all types of retail projects, including regional enclosed malls, lifestyle community centers, neighborhood centers, and mixed-use projects. Members of the Retail Group include attorneys who are experts in sales and acquisitions, design, engineering, and construction contracts, reciprocal easement agreements, development and management agreements, and leasing.

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