RETAIL PERSPECTIVES

2013 FORECAST

As we have done for the past four 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 2012, reviewed various economic data and projections and have come to certain opinions relating to the retail industry and where it is heading in 2013. 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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CAPITAL IN 2013 – PROMISING DEVELOPMENTS; IS IT ENOUGH TO CHANGE FROM "THE BEST AND ALL THE REST?"

By: Gary Glick

As we predicted last year, 2012 turned out to be a year of slow but incremental growth for the economy; albeit one that was dominated by the presidential political campaign. Employment gains continued at a reasonable if not robust pace, picking up towards the last few months of 2012. The stock market surged, and Europe seemed to have averted any major sovereign debt crisis. Retail sales for November and December increased about 3% over the same months for the prior year despite hurricane Sandy. Consumer confidence showed signs of growth. According to the *ChainLinks Retail Advisors U.S. National Report* (the "*Report*"), the "Conference Board's Consumer Confidence Index (CCI) reached

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THE RETAIL MARKET IN 2013 – POISED FOR RECOVERY

CORE FUNDAMENTALS ARE RETURNING

By: Scott Grossfeld

The future of the U.S. retail market in 2013 appears to be something of a "mixed bag of goods". Continued political and other pressures may work to hold back retail and economic progress. However, strong, rejuvenated fundamentals should prevail, resulting in a year in which retail will grow, particularly in the second half of the year.

As in past years since the recession, there is good momentum in the retail industry coming out of the 2012 holiday selling season. Although early reports were somewhat more conservative to glum, a recent article in *Commercial Property Executive* reported that the Census Bureau's report of U.S. retail sales were up 0.5 percent from November to December last year, and the year-over-year retail sales increase in December was 4.7 percent. According to the article, if

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RETAIL DEVELOPMENT – READY TO TURN THE CORNER?

By: Dan Villalpando

As in recent years, those in the retail industry welcomed 2013 with cautious optimism. Calendar year 2012 turned out to be a decent year for retail developers (and retailers) with estimates that retail sales in 2012 rose approximately 5.2% over 2011. While such growth is not as robust as many had hoped, it does represent movement in the right direction, and begs the question: Can we expect to see even more improvement in 2013? Based on recent events in Washington, a slight uptick in job creation, and some positive news regarding the housing market, it appears as if there may be reason to expect better things in retail development this coming year.

One issue that likely will have an effect on the retail industry, as well as consumers in general, is the so called "fiscal cliff", which was at least partially addressed on the first day of 2013. The deal agreed to by the President and Congress made permanent the Bush-era tax cuts for roughly 98% of Americans (those individuals earning $400,000 or less, and families earning $450,000 or less). On its face, such a compromise should stimulate the economy by providing the 98% with disposable income that they would not have had if the Bush-era tax cuts had been eliminated altogether. However, another component of the compromise may work to take some of those dollars away from employees, regardless of their economic status. The expiration of the payroll tax cut, which ends a 2% discount employees received on the funding arm of Social Security, will result in less take home pay for most workers (one prediction is that approximately $125 billion will be taken out of the pockets of American workers). So, while we Americans may have avoided falling off the "fiscal cliff", it is unclear whether the compromise reached in Washington will result in more dollars available to be spent in shopping centers or other retail establishments. It should also be noted that, in reaching a compromise, the President and Congress did not resolve all of the issues that brought us to the "fiscal cliff", not the least of which involves potential spending cuts. Until final resolution of those issues occurs, it remains to be seen if the general public will be more willing to part with hard earned dollars in 2013 than they were in 2012.

A second factor which impacts retail development is the job market. Relatively high unemployment continues to plague the U.S. economy, although there are some optimistic signs. Through October 2012, there had been created approximately 1.6 million new jobs, or roughly 160,000 jobs per month. In November, the unemployment rate in California dropped below 10% for the first time since the beginning of 2009. And, according to the UCLA Anderson Forecast, employment in California is expected to increase an additional 1.3% this year, and, by 2014, the jobless rate is expected to decrease to 8.4% (from a current 9.8%). With more Californians (and Americans) employed, there should be a concomitant increase in consumer spending, much of which will likely find its way to shopping centers.

Another sector of the economy which has a major influence on retail development, and which has been relatively stagnant for the last several years, is housing. It is no great mystery that if new housing developments are built, new shopping centers will follow. And, for the first time since the beginning of the "Great Recession", it appears as if there may be some optimism in the housing market. The resolution of the myriad foreclosures, the influx of institutional investment and the force of the expanding population may all contribute to a housing turnaround in the near future. As with the economic policies in Washington, however, there is no certainty regarding the housing market, and retail developers will be likely to adopt a "wait and see" approach before taking risks on new development.

Those retail developers who are not willing to take the risk on new development will likely remain focused on the "Five Rs": renovation, rehabilitation, repositioning, releasing and refinancing. As has been the case in recent years, shopping center owners with existing product that they want to keep are spending money on renovation and rehabilitation. Such work includes common area and building improvements, in addition to upgrades to accommodate the savvy shopper who requires instant access to his or her mobile device. Other shopping center owners may work to reposition their portfolios by shedding under performing assets, while attempting to acquire Type A properties which boast higher rents and less required maintenance.

The ability to re-lease in existing product remains an important component of shopping center ownership. As in recent years, there continues to be a significant amount of second generation space hitting the market due to the downsizing of "mid-box" or "junior anchor" tenants like Old Navy and Best Buy. In addition, some analysts predict that up to 300 grocery stores in the U.S. will shutter their stores in 2013, resulting in additional space on the market. Such closures will significantly impact owners of neighborhood centers, which are commonly anchored by grocery (and drug) stores. This number does not include closures that may result from the withdrawal of Tesco from the United States market, which plan was announced toward the end of 2012.

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2013 – A NEW HOPE FOR HOUSING?

By: Matt Seeberger

Barring unforeseen circumstances, for the first time since the Great Recession began, it appears that the housing market will finally have sustained growth in 2013, which should boost new housing and thus retail development. This differs significantly from the past several years when the outlook was decidedly uncertain, as various forecasts indicated that the economy, which was supposed to have bottomed out a couple of years ago, was experiencing a bumpy recovery, forestalling progress in new housing and making the environment for new retail relatively inhospitable.

The federal government is a major factor in the recovery of the housing market in two important ways. First, the Federal Reserve Bank has indicated that it would keep the benchmark interest rate near zero as long as unemployment remains above 6.5% and it projects inflation will be no more than 2.5% in the next couple of years. Second, Congress and the President avoided the "fiscal cliff" (at least for now) with a last minute bill (H.R. 8, the American Taxpayer Relief Act of 2012), which permanently extends most of the 2001 and 2003 tax cuts. If those had expired as scheduled, around $600 billion would have been taken away from consumers, which could well have sent the U.S. back into recession.

Another factor that is beginning to have an impact on the housing market is the rapid escalation in rents across the nation, caused in part by the drop in vacancy rates, from 11% at the peak of the recession to just over 8.5% (an almost 30% improvement), meaning that we are nearing the more typical vacancy level of 7% to 8%. In the third quarter of 2012, average effective rents increased almost 3% over the third quarter of 2011, higher in more active markets (such as San Jose [over 4%] and San Francisco [almost 6%]). Further, occupancy rates have recovered to historically normal rates in the majority of markets, an indicator of the improving job market as young adults who had moved back in with their parents when job opportunities were scarce are now finding employment and moving out, the first step to home ownership. All of the foregoing, when combined with the bottoming out of home prices, means that there is strong renewed interest in purchasing homes, as renters seek to maximize the value of their housing dollar. This will in turn reduce the inventory of vacant houses, a major contributor to the lack of new housing construction.

However, improvement will be somewhat tempered by the overall make-up of housing, which may have, at least for the near future, been altered due to higher gasoline prices, the emphasis on "walkable" neighborhoods (for a moderate income family, getting rid of one car can result in a 10% to 15% increase in disposable income), and the fact that renters are more flexible in adapting to the rapid changes in the job market, having much less money tied up in what has traditionally been the single largest investment for an American family – their home. While new housing construction is on the rise, much of it is for multi-unit apartment buildings intended to be rented – the pace of multi-family construction starts in 2012 was double what it was in 2009 and 2010, and the ratio of multi-family rental units to single family and for sale condominium units is changing.

In addition, the lack of new home building for the past several years is now adding to the strength of the recovery of the housing market, as demand is starting to outstrip existing supply, making it more feasible to invest in new housing construction. In 2012, there were about 600,000 units built, and for 2013 that number is projected to increase to around 750,000, with new housing starts anticipated to be in the 1,000,000 range (according to the federal government, seasonally adjusted rates for private housing starts in November 2012 increased to 861,000 over November 2011's 708,000, and home building completions rose 16%). It is estimated that the annual need is between 1,400,000 and 1,500,000, so the unsold inventory should start dropping. While the current pace is far less than the 2,500,000 from 2005 (which the past half decade has shown is unsustainable), it is far better than in prior years.

The economy continues to improve, with the Federal Reserve predicting 3% growth for 2013 (note that some commentators are more cautious, suggesting that growth will be around 2%), with the recent history of significant swings in gross domestic product growth rate in the past four years being replaced by slow but steady improvement. Unemployment is falling, from around 9% nationally at the end of 2011 to about 8% by the presidential election, and is expected to drop to 7% by the end of 2013. While the decrease in unemployment has not occurred as fast as many had hoped, the cumulative effect is still enough to make continued job growth a strong likelihood, which will further bolster the ability of consumers to purchase existing homes and thereby increase the incentive to build new homes. Added to that is the fact that the overall financial well-being of Americans has improved significantly, with collective debt in 2012 down to $11.3 trillion from $12.7 trillion in 2008, meaning that there is significant additional wealth to invest in houses.

A number of commentators have noted that the housing market is now having a positive impact on the overall economy, a

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Capital In 2013 – Promising Developments; Is It Enough To Change From "The Best And All The Rest?"

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73.7 in November. While this remains well below the historical average of 95.0, it is the highest level of consumer confidence recorded since February 2008 when it measured 76.4." The other major development of 2012 was the "uptick" in the residential housing market. Among numerous commentators, Wall Street seems convinced that the housing depression is over for good - An index of 11 major builder stocks rocketed 80% in 2012 to the highest level since mid-2007. It is ironic to note that the real estate sector that plunged the U.S. into recession, may be the sector that is most influential in leading to a recovery in the retail industry.

As of the date of this writing, the biggest obstacle in the way of economic recovery may be our representatives in Washington. Although they were able to avert the first potential "fiscal cliff" crisis by reaching a "last minute" agreement on preventing tax increases most Americans in 2013, it is still incumbent upon them to reach an agreement which would begin to bring down the ever ballooning national debt. To do so, they must avoid the potential devastating impacts of sequestration and a government shutdown or credit rating downgrade in connection with a stalemate over increasing the debt ceiling to pay for already accrued governmental expenditures. Though it has been endlessly politicized, the impact of a government shutdown or credit rating downgrade could be a significant enough shock to the economy that could slide the United States economy back into a recession. However, since the remaining "fiscal cliff" issues are "man-made", we will assume for the purposes of this Article that the politicians in Washington will show some level of responsibility and fashion a compromise with respect to these issues that will not lead to economic calamity.

As stated in the *Report*, "Retailer expansion in 2013 is still about 'the sure thing;' urban over suburban, Class A and B over Class C, and locations with greater population densities and higher income demographics still winning out most of the time." The same can be said for capital. For the most part, capital in 2013 will chase Class A properties, developers with proven track records and housing and population densities. As was the case in 2012, significant capital was available in the market for the purchase of income producing retail properties meeting these criteria. With interest rates at historical lows and the stock market continuing to show volatility, "cap" rates for these properties remained at historical lows. Also driving investment sales in the fourth quarter of 2012 was property owner's fears that capital gains rates would rise in 2013 (which, in fact, they did). Title companies reported more volume in the fourth quarter of 2012 than at any time since 2007. We expect interest rates to continue to remain extremely low for at least the next two to five years, leading to more of the same with investment sales. The only significant change may be the return of capital for less than Class A properties as the economy continues to improve. However, as of this date, although assets in secondary cities and tertiary markets offer greater yields, they continue to be outside the risk/reward threshold of a majority of the investment community.

With respect to the debt markets, lending will have many of the same characteristics we are seeing with investment sales. According to *2013 Emerging Trends in Real Estate* (published by the Urban Land Institute and pwc) ("*Emerging Trends*"), "good assets with solid income streams and good credit borrowers will have no trouble attracting financing from life insurance companies and banks eager to choose from the pick of the litter. As markets improve, more properties will enter this worry-free zone, and rich-can-get-richer mortgagors [will] lock in 'exceptionally cheap money.' But players with bad credit and/or marginal assets, who need capital infusions to keep afloat, [will] continue to find themselves cast aside or placed in extend-and-pretend limbo. 'It is still the best – and all the rest." In this environment, lenders will continue to hold onto a significant number of underperforming loans. However, as housing continues to strengthen and a market begins to become available for more than Class A properties, some of this product may start to reach the marketplace.

In 2012, portfolio banks continued to lend but remained cautious about underwriting standards and sponsors. Most new loans continue to chase "core" properties in top tier geographic regions. With no secondary market, these banks continue to "lay off" some of the risk of larger loans by bringing in participating banks or co-lenders. Banks are still in no rush to sell distressed assets and take losses. They will continue their preferred strategy of extending many loans with

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modifications rather than refinancing or disposing of them. As in 2012, they would rather wait for more promising opportunities and avoid balance-sheet issues until markets improve. It is interesting to note that many of the underwater assets of these banks may be among their highest yielding assets as long as these loans remain current. Much like in 2012, typical loan to value ratios for bank permanent loans will range from 50% to 70%. Terms will be short – typically in the 5 to 10 year range with amortization over 30 years, and interest rates will be in the vicinity of 1.5 to 2 basis points over the 10 year treasury yield. Interest rate swaps will continue to be required of many borrowers as a hedge against significant interest rate fluctuations. Banks will also make construction loans to preferred sponsors with development deals in densely populated "top-tier" markets. However, significant pre-leasing will be required. These loans will be short term (*i.e.*, 3 to 5 years), will require significant equity (20 to 40%), will be recourse, and will typically have interest rates in the vicinity of LIBOR plus 3%, with a "floor" in the neighborhood of 5%.

As in 2011, life insurance companies remained extremely active in 2012, and will continue to be active in 2013, especially without any significant increase in the CMBS market. As with banks, the underwriting of life insurance companies will remain very strict since they have plenty of options available. They will continue to originate record volumes, usually with high-credit clients, and with loan-to-value ratios of around 65%. The life insurance companies are not as concerned about values as they are cash flows. Life company loans will continue to be predominantly permanent loans with terms between 5 and 10 years. They will be non-recourse loans with fixed interest rates between 3% and 5%, and with amortizations between 25 to 30 years. It should be noted that some of the life companies are beginning to require floating-rate debt to hedge against the current low-interest rate environment. The life companies will continue to confine their lending to Class A assets in "top-tier" geographic regions. Unfortunately, they will not fill the lending void in helping troubled borrowers owning Class B or C properties.

CMBS originations continued to remain tepid in 2012, especially compared to the ten year period before 2008. With more stringent regulations and not much capital chasing Class B and C assets, commentators do not see any major strengthening of the CMBS market in 2013. As stated in *Emerging Trends*, "the CMBS market may need to confront bigger obstacles in order to rebound. Although most interviewees contend that a properly functioning mortgage securities engine is necessary for liquidity in the real estate capital markets, they also express serious concerns about the failures to address evident problems in CMBS underwriting, regulation, ratings and servicing since the marked collapse at the depths of the credit crisis. The problem for bond buyers remains: the people running CMBS shops have 'shuffled around,' underwriting is only marginally better, originators and issuers 'don't have enough skin in the game' for an alignment of interests, the rating agencies still get paid by the issuers, and 'attitudes haven't changed.' In short, 'nothing meaningful has happened' to correct the problems, which sent bond buyers running to the exits."

As in 2012, mezzanine debt and preferred equity will remain plentiful for Class A assets since the returns achieved by these investors far exceed anything that can be obtained on the traditional debt side, although the risks to these investors are considerably greater. This money is necessary for borrowers to meet the stricter equity requirements of lenders and for refinancing or restructuring existing debt. However, this capital will continue to come at a high cost – projected "equity-like returns" in the 9 to 12% range.

Absent a major upheaval caused by the inability of our politicians in Washington to reach reasonable compromises on debt reduction and the debt ceiling, 2013 could finally be the year when the economy starts to pick up a more significant amount of momentum. It will not be substantial, but with housing and job growth continuing to rise, we may finally start to see the "seeds" of new retail development and the return of may retailers to the marketplace. This could eventually lead to the return of capital to secondary and tertiary markets. This alone could create an environment of major new growth in the economy. Considering what the retail industry has endured for the last five years, we are pleased to report some promising developments for 2013 and beyond.

The Retail Market in 2013 - Poised For Recovery
Core Fundamentals Are Returning

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automobiles and fuel are removed from the equation, then the annual increase grew 5.1 percent. These are larger percentages than originally predicted and reported.

The holiday season growth in retail spending is even more significant when considering much of this spending took place during the recovery from Superstorm Sandy. A significant number of consumers, covering a large portion of the Northeast were out of commission during peak spending periods as a result of the storm. In addition, the holiday period was hampered by the federal government's "Fiscal Cliff" stand-off. Undoubtedly, many consumers were more conservative and cautious as a result of the uncertainties and concerns of potentially going over the "Fiscal Cliff". Without these powerful negative forces, one could speculate that the holiday sales period would have been even more successful.

In addition to good momentum coming out of 2012, the economy is starting to show signs of re-establishing some of the strong, core fundamentals that many believe are necessary to long term retail growth.

A significant reason to be optimistic about retail in 2013 is about a sector of the economy that led us into the recession initially, and, according to the *2013 ChainLinks Retail Advisors U.S. National Report* (the "*Report*") will likely lead us out – housing. Housing usually leads our economy out of recessions, but for the past several years the housing sector has been absent.

The change in 2013 is that housing appears to have started to rebound. According to the *Report*, new home starts are at their highest level since before 2008. Permits remain high – which means that this trend should continue for at least the foreseeable future. And, new sales are at their highest level in over 2.5 years. If these statistics continue, and housing is back, 2013 should be a year in which gradually improving housing fundamentals continue to grow and accelerate and begin to drive economic growth. It is estimated that over 2 million construction jobs were lost in the recession. As housing comes back, so too should construction jobs – but gradually, not all at once. In addition, as more jobs and products are created, the overall national economy should grow, since more money is filtering into the economy through jobs and more consumer spending. Many predict that this growth will be seen in the latter half of 2013 and beginning of 2014.

In addition to new home starts, according to a recent Article in *Commercial Property Executive*, home prices in general (including existing homes), are on the increase. According to the article, all but six states are experiencing year-over-year price gains on pending home sales. Nationally, home prices appear to have increased approximately 7.4 percent from November, 2011 to November, 2012. These increases are predicted to continue to trend higher in the near future.

These developments in housing are significant. As more families and people invest in homes, a greater demand will be created for home improvement, décor, furniture and related goods, which should benefit the growth of those stores that sell these products and suffered during the recession. This should not necessarily work to the detriment of the stores that did well in the recession, such as grocers, drug stores, health clubs, sporting goods stores, pet supply stores, restaurants and discount-oriented stores. The good habits learned during the recession, especially with respect to buying at discounts, will be hard to forget. However, as home wealth returns (in the form of equity), some of the types of stores that were squeezed out due to higher price points, should start to make a come back.

Another major fundamental on the mend is unemployment. According to the *Report*, over the course of 2011, the U.S. economy created approximately 1.84 million jobs, and in 2012 (through October), approximately 1.569 million jobs. This appears to be a modest pace of job growth for a recovery. Of course, job growth could be worse, and the economy could be growing fewer to no jobs. On the other hand, it is somewhat reassuring that jobs are/were being created at a rate of approximately 157,000 positions per month, while there were so many outside negative forces potentially working against growth. Over the past two years, the political and economic landscape in the U.S. had to endure, among other things, a hotly contested presidential election, a lame duck Congress, crippling bi-partisanship politics, a "Fiscal Cliff" stand-off, a debt ceiling stand-off and a national credit downgrade. Many of these obstacles were self-imposed or self-created. Some may say that it was remarkable that so many jobs were created despite the negative environment, or that we have a growing economy fighting to get out. In any event, now that the presidential election is over and a new Congress has been sworn-in, perhaps all sides can work together to expand job growth to its greatest potential in this recovery.

Of course, job creation is a core fundamental to retail growth. More jobs, means more consumer spending, more stores, more rent and more retail development, and it has a spiraling effect.

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The Retail Market in 2013 - Poised For Recovery
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Consumer confidence is also on the rebound. According to the *Report*, the Conference Board's Consumer Confidence Index (CCI) reached 73.7 in November of 2012. This was the highest level of consumer confidence recorded since 2008. The relationship between consumer confidence and consumer spending is a loose one. However, eventually, consumer spending almost always mirrors the CCI. This is further reason to be optimistic about retail growth going forward.

Notwithstanding all of the good news and metrics, not everyone sees retail the same way. According to a recent *Wall Street Journal* article, some experts saw only slight growth in U.S. malls and strip centers in the fourth quarter of 2012, and point to a lackluster 2013 for retail landlords. These experts seem to be concerned about perceived weak job growth, Federal budget cuts and tax increases and their affect on consumer confidence. That said, there does seem to be some acknowledgement for continued retail success in some of the top markets – the markets with the lowest vacancy rates (some of the more affluent suburbs in California and New York and other high density areas with strong income demographics).

Some of these concerns are very valid. Indeed, the "Fiscal Cliff" was averted at the beginning of the year in terms of avoiding various tax increases for the majority of Americans. However, later this year, Congress and the President will square off over major budget and spending cuts. Will this lead to another stalemate or crisis? Will the cuts affect jobs – reduce jobs? How will the cuts impact taxes? To the extent these questions are answered in the negative, they will have a negative impact on the retail economy and retail development.

In addition to working through spending cuts, Congress and the President are also scheduled to come to an agreement later this year on another debt ceiling compromise. The same questions could apply to the outcome of this debate.

As the Congress and President did before, will they again play a game of brinksmanship? Will the country and the economy be left guessing how these issues will be worked out until the bitter end, and will this affect our economy for the worse?

* * *

A foundation has been laid for a good recovery in the retail market. Some strong fundamentals are taking hold and helping to create real growth. There is good reason for optimism in 2013, especially towards the second half of the year as housing is predicted to pick up. There is also reason for concern about sources that could derail this growth. However, it is our hope that the roots of core fundamentals have grown deep enough to sustain these potential strains.

Retail Development – Ready To Turn The Corner?

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To fill vacant space, shopping center owners are looking to those categories of tenants that have survived the past five years and are currently looking to expand. Restaurants continue to gobble up vacant space, led by quick service tenants like Subway and Five Guys Burgers. However, those tenants do not typically lease large amounts of space, which is where discount or dollar stores such as Ross, Dollar General, Family Dollar and Dollar Tree, come into play. Those tenants are often very willing to take on second generation space (with footprints varying from 5,000 square feet to 25,000 square feet), often at attractive rental rates. Indeed, some analysts have predicted that dollar stores alone will account for a minimum of 15 million square feet of occupancy growth across all retail building types in 2013. In addition, there appears to be a resurgence of "Mom and Pop" tenants willing to lease smaller space (less than 3,000 square feet). Such tenants are finding financing more readily available than in recent years. For the same sized space, retail developers are also looking to check cashing operations, shipping stores, spa concepts and hair salons.

Other retail developers are looking to re-lease vacant space to concepts not traditionally associated with shopping centers,

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Retail Development – Ready To Turn The Corner?

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such as go-cart tracks, trampoline facilities, day care centers, cooking schools and even swim schools for kids. Of course, the ability to add such non-traditional tenants must be balanced against the rights of other existing tenants that may have the ability to keep certain uses out of a given project. A non-traditional use may allow a retail developer to temporarily re-lease space and get some rent in return, but adding such uses may upset major or anchor tenants at a project, who may decide to aggressively fight the new uses, or to leave the project when their current term expires, rather than renew or exercise available options.

With interest rates holding steady and at historic lows, some shopping center owners are taking the opportunity to re-finance current loans. In reviewing these requests, lenders are looking at the real estate collateral and trying to make sure that vacancy levels hold steady, or are reduced, so that the income stream from rent continues unabated. Therefore, shopping center owners may be required to "re-lease" before they are able to "refinance", thereby obtaining an occupancy rate that will satisfy their lenders and allow them to obtain financing at the attractive rates the market currently offers. It is unclear how long interest rates will stay low, but the Federal Reserve recently announced that it is linking interest rate increases to job growth, and rates are expected to remain unchanged until the unemployment rate in the U.S. drops to about 6.5%.

As has been the case in recent years, retail developers (whether re-leasing existing product or leasing new, ground up development) are forced to acclimate to changes in the marketplace. For example, the Internet continues to have a profound impact on the shopping center industry. Some retailers are experimenting with so-called "click-and-collect" shopping where the customer orders online and then picks up the goods at a store nearby. Other retailers have launched opt-in mobile programs (otherwise known as "geofencing") where promotions or other messages are sent to consumers when they are in a store, or within range of a store. For example, Best Buy plans on using eBay's price comparison application, RedLaser, to deliver information to customers regarding in-store specials and other pertinent information. Those retailers who use "geofencing" hope that it will work to offset (at least to some extent) the damage caused by "showrooming", where customers travel to various retailers to price goods, only to ultimately purchase them from unrelated vendors on the Internet. To accommodate such shifts in the marketplace, retail developers will be forced to provide, or strengthen, certain services (like Wi-Fi signals) in their shopping centers to attract and keep those tenants who are attempting to use the Internet to their advantage.

Retail developers who are looking to expand their portfolios may continue to experience a buyer's market in 2012, according to some analysts, who view the market as undervalued and ripe for investors. Indeed, in just the first few days of 2013, industry giants such as Simon Property Group, Federal Realty Investment Trust and DDR Corp. all announced major transactions involving existing shopping centers. Not surprisingly, class-A product is the most attractive to buyers, but owners of that type of asset may be reluctant to sell in the current economy. Time will tell whether more shopping centers will change hands during 2013, but if the first few weeks are any indication, there may be more large scale transactions on the horizon than we have seen in recent years.

When it comes to the world of retail development, not a whole lot has changed from the end of 2011, as we move further and further away from the robust years we experienced earlier in the century. However, 2013 brings with it at least some optimism that other aspects of the economy (especially jobs and housing) may be turning around for good. If such a rebound occurs, shopping center owners may be in for a better year in 2013.

2013 – A New Hope For Housing?

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welcome reversal from the last four to five years, when it most certainly had a strong negative effect. Based on the Federal Reserve's commitment to keep interest rates low, it is likely that even if interest rates were to rise, that would most likely be because there is positive economic growth, leading to an improving job market (always a critical factor in home purchases), so the outlook is generally positive. As with 2012, though, the impact of international events may temper growth in the U.S., particularly the continuing problems for European economies and the slowing of growth in China, Brazil and India.

Nationally, new home sales rose in 2012 on a more consistent and stronger basis than in prior years, with pending homes sales up almost 10% in November 2012 when compared to November 2011. Some positive statistics are first, that the inventory of unsold homes was reduced in November 2012 to 4.7 months worth, the 5th month in 2012 at that level, all of which were the lowest since 2005, and the normal housing vacancy rate of 1.5% is also being approached, having dropped to 2.1% from the high of 3%. Further, the National Association of Home Builders anticipates that new home sales will increase substantially in 2013. In 2012, sales of newly-built homes rose 4.4%, the highest level since the first home buyer tax credit ended in April 2010. According to the Los Angeles Times, sales of never-occupied homes are up almost 22% over a year ago, with overall home sales at their highest level since the tax credit in 2009 and 2010, all of which will contribute to new retail development.

Home prices are continuing their upward trend, with the median price up 10% to 15% over last year's figures (although some of this may be due to price increases in construction materials). The S&P/Case-Shiller index of home prices showed an overall gain in home prices of more than 4% over the past year, with gains in the vast majority of the markets it analyzed. Of particular interest to California home builders and retail developers is that housing prices in the state have seen some of the strongest gains in the nation, welcome relief after California (along with Nevada, Arizona and Florida) suffered so much during the downturn. Two years ago, over a third of the metropolitan areas with the largest drops in housing prices were located in California; now, California metro areas are leading the way in increases. The Los Angeles Times reported in late December 2012 that the median prices of all houses and condos in California rose over 19% when compared to a year ago.

Finally, foreclosures (and their brethren, short sales), one of the biggest drags on the housing market during the recession, continue to fall as a percentage of the overall sales volume, which will also boost home prices and demand for new housing. As the Los Angeles Times reports, sales of foreclosed homes are down to around 17% of all sales, half as much as in November 2011 and the lowest level since October 2007 (recall that in prior articles it was noted that the figure was 59% in 2009, 38% in 2010 and about 33% in 2011). Nonetheless, the California Association of Realtors cautions that it may take a few more years for the California housing market to fully recover, particularly since the Central Valley and Inland Empire still have large amounts of REO properties and continue to have higher than normal foreclosure rates.

In summary, for the first time since 2007, it appears that there is reason to be optimistic about housing generally in 2013, which should bode well for new housing construction, which in turn (and in time) should boost retail development to a level that has not been seen in some time, though probably not to level experienced in the boom years of the mid 2000's. Unfortunately, the cost of transportation, both in dollars and in time spent commuting, will probably continue to dampen to the attractiveness of far-flung housing developments that characterized the mid-2000s, meaning that new shopping centers in the exurbs – one of the traditional pillars of retail development – will probably be the last category of retail to recover. So, while there is no doubt that the rate of new home building is not keeping up with the increasing demand, it is likely that the best opportunities for retail development, as in the recent past, will be in areas that have existing housing stock to fill. Once there are jobs to support new construction in outlying areas, new retail centers will again be needed.

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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