Where's the money and where can you get it?

David Blitz

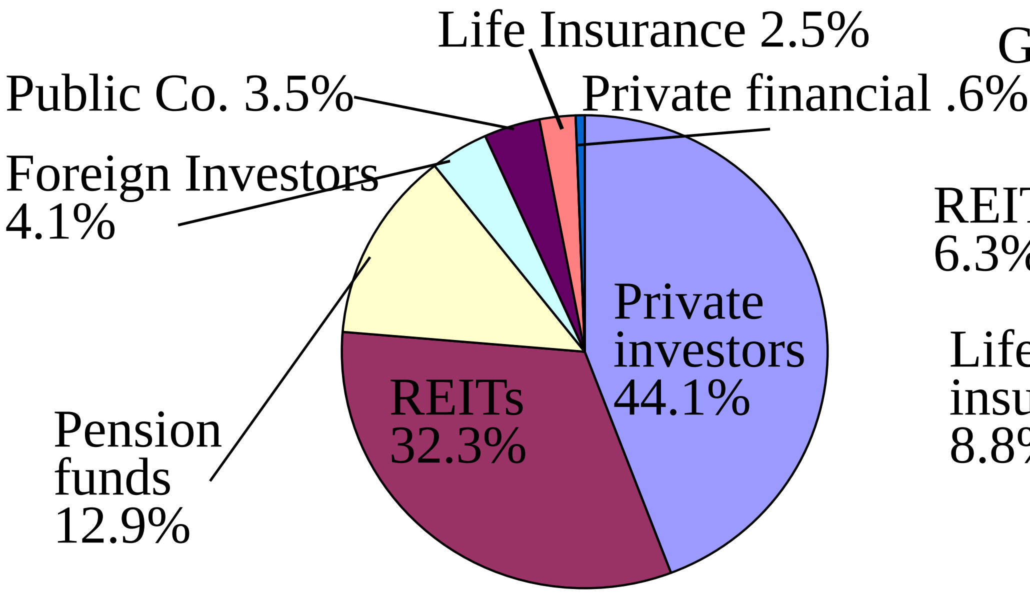
Jeff Hudson

Alan Goodkin

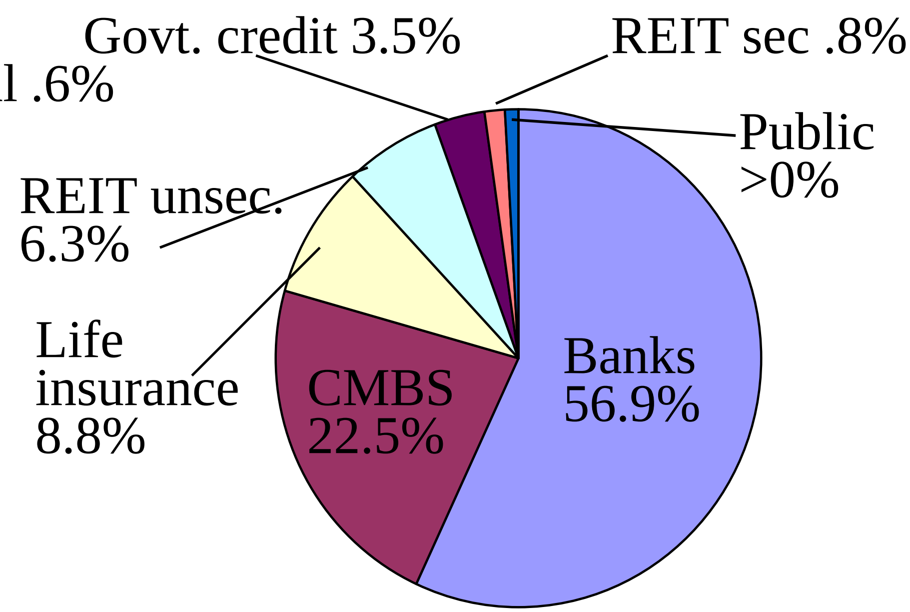
Tom Lockard

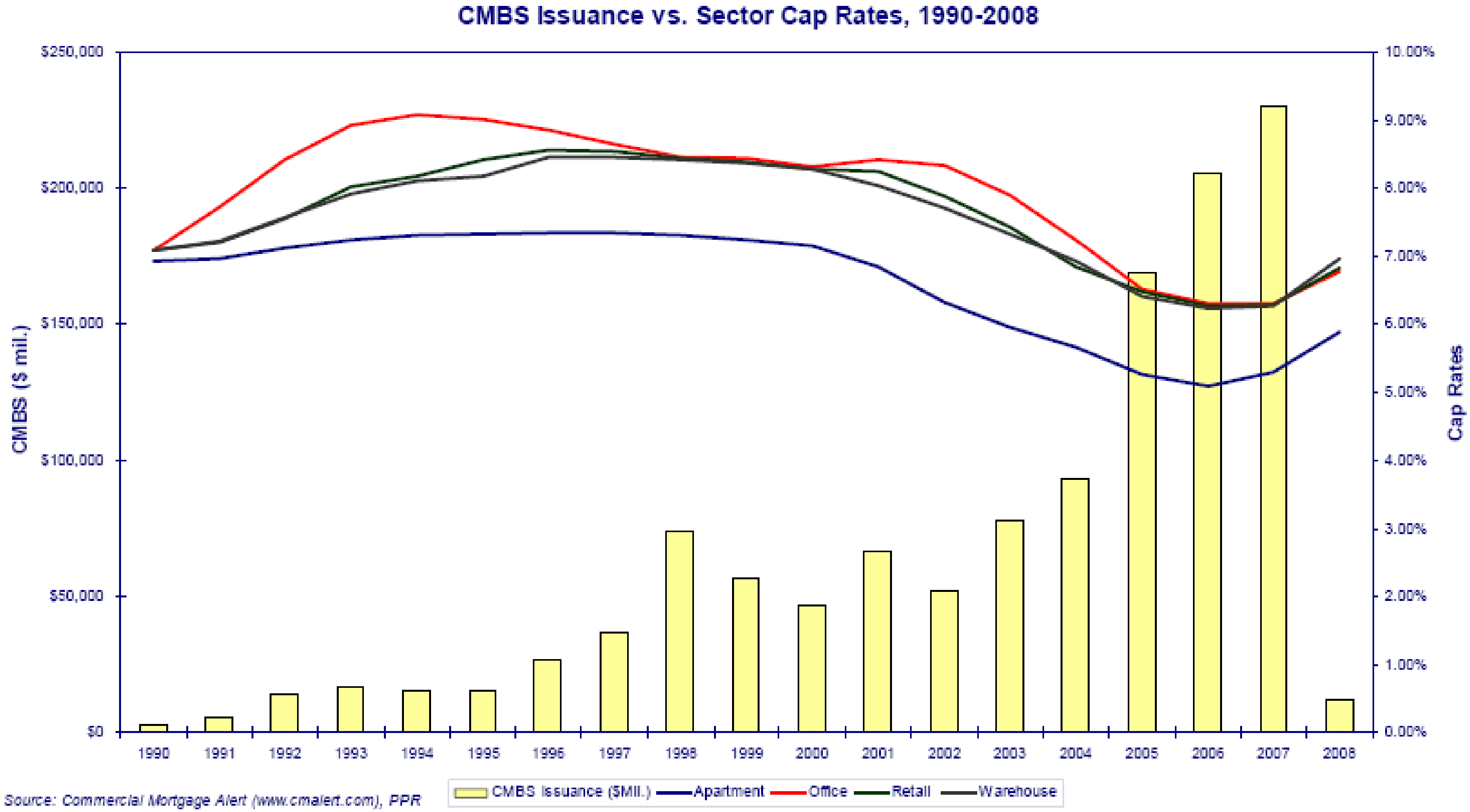
$4.575 trillion invested in U. S. private real estate in 2007 (2008 Emerging Trends)

28.1% was Equity

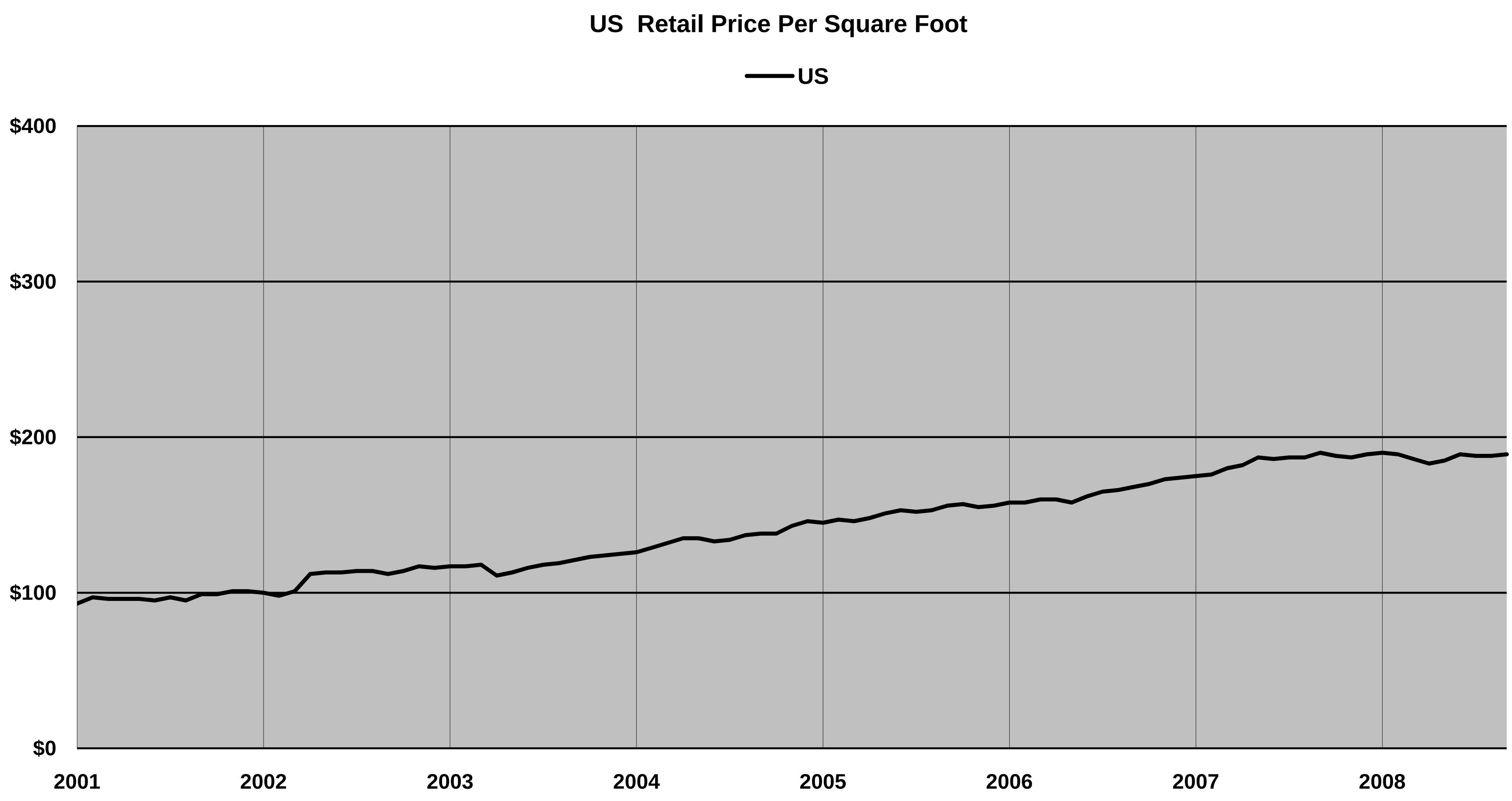


71.9% was Debt



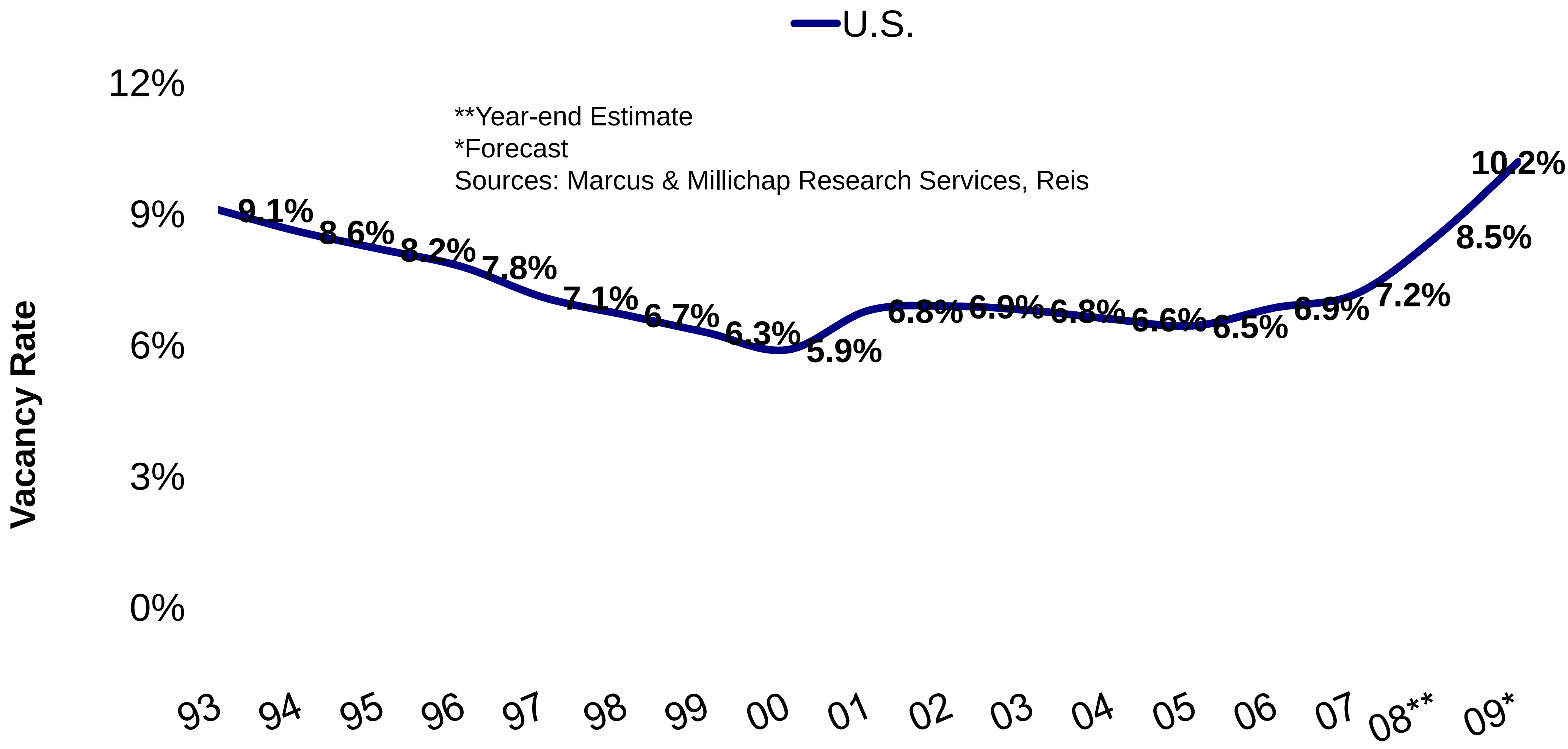


Source: Commercial Mortgage Alert (www.cmalert.com), PPR


US Retail Price Per Square Foot
US
$400
$300
$200
$100
$0
2001
2002
2003
2004
2005
2006
2007
2008

Source: CBRE

Retail Vacancy on the Rise!



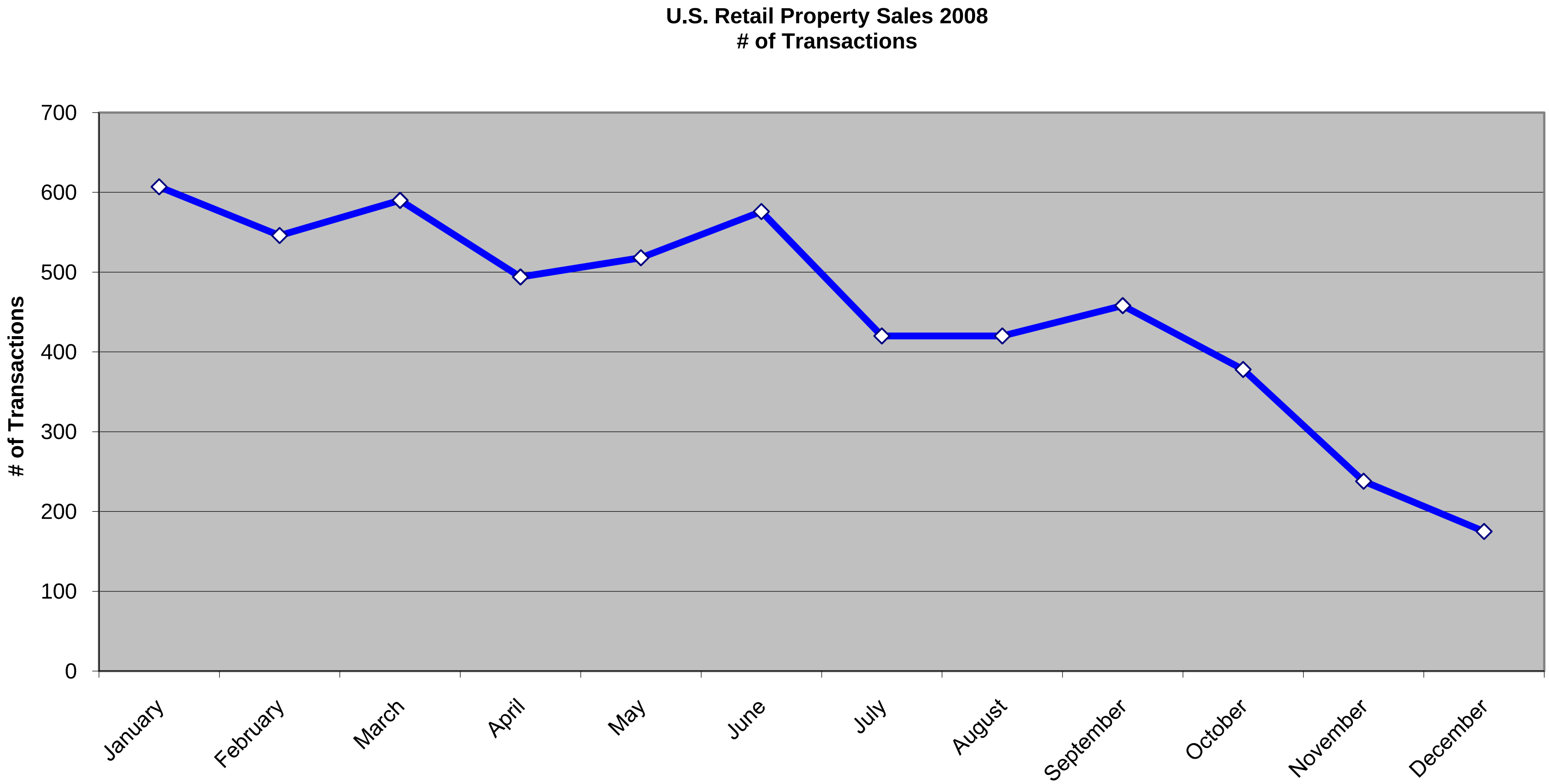
Source: CBRE

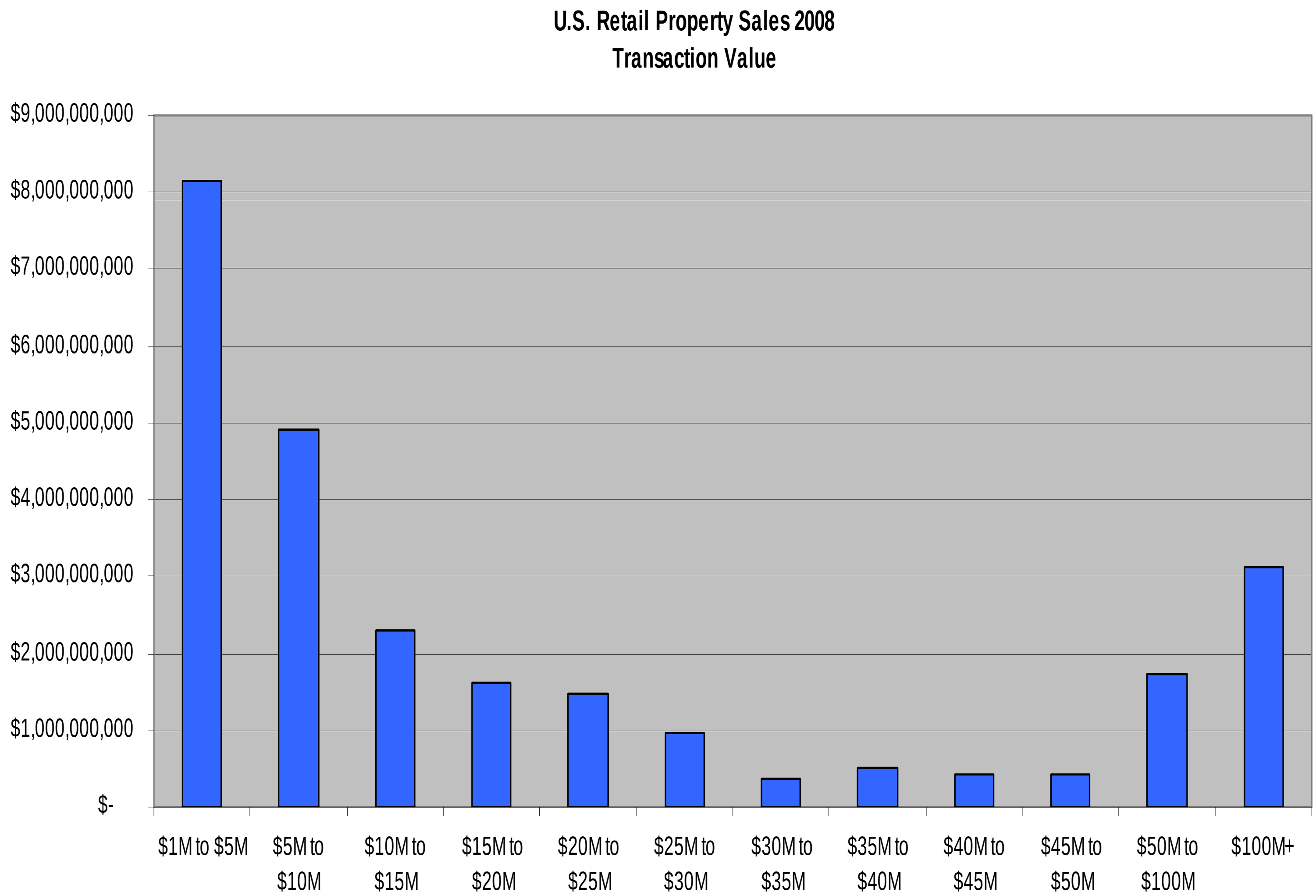
Projections of retail vacancies by Property & Portfolio Research (PPR)

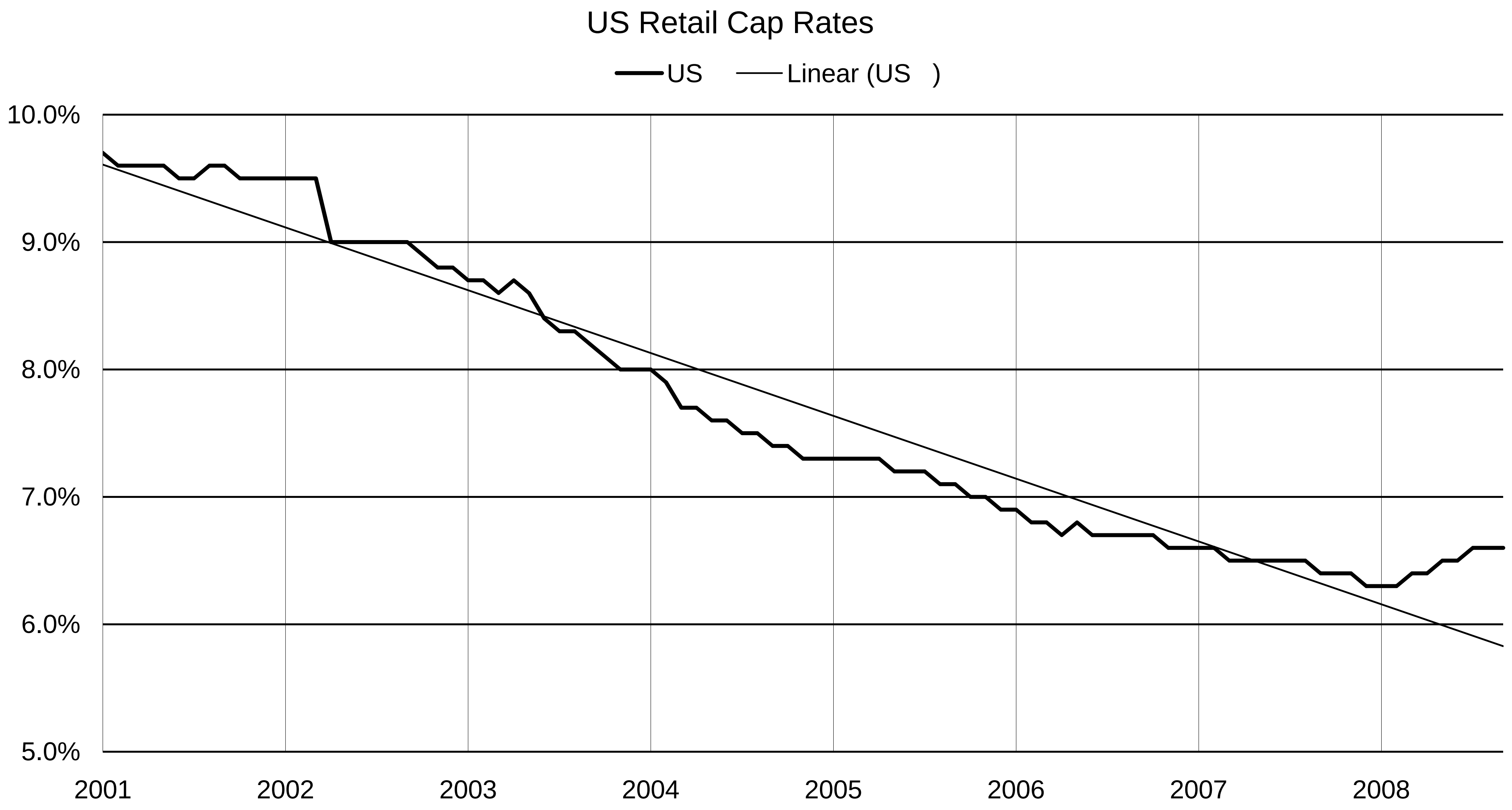
Reports…show a rapidly rising number of shopping center vacancies around the country. PPR predicts that **overall retail vacancy rates will reach 12.5 percent**—

This may not sound so bad, but…it represents overall…roughly **40 square miles (103.6 sq km) of empty and abandoned stores and another 100 square miles (259 sq km) of unused parking lots.**

Retail rent growth is projected to decline by more than 5 percent in 2009 before recovering in 2010, and **retail capital value losses may approach 20 percent.**


U.S. Retail Property Sales 2008
# of Transactions
# of Transactions
700
600
500
400
300
200
100
0
January
February
March
April
May
June
July
August
September
October
November
December


U.S. Retail Property Sales 2008
Transaction Value
$9,000,000,000
$8,000,000,000
$7,000,000,000
$6,000,000,000
$5,000,000,000
$4,000,000,000
$3,000,000,000
$2,000,000,000
$1,000,000,000
$-
$1M to $5M
$5M to $10M
$10M to $15M
$15M to $20M
$20M to $25M
$25M to $30M
$30M to $35M
$35M to $40M
$40M to $45M
$45M to $50M
$50M to $100M
$100M+


US Retail Cap Rates
US
Linear (US)
10.0%
9.0%
8.0%
7.0%
6.0%
5.0%
2001
2002
2003
2004
2005
2006
2007
2008

MICHAEL BEYARD

The Retail Bubble

A beggar-thy-neighbor approach has led to serious land use distortions in the United States that we have known about for years, but have so far failed to do anything about.

A NEW BUBBLE IS POPPING—and as usual it was avoidable. But unlike the housing bubble, many local communities and developers—not residents—played the key role in creating America's retail bubble. Reports by Property & Portfolio Research (PPR), based in Boston and London, show a rapidly rising number of shopping center vacancies around the country. PPR predicts that overall retail vacancy rates will reach 12.5 percent—one out of every eight square feet (0.744 sq m) of available retail space.

This may not sound so bad, but as reported by Globestreet.com, it represents overall about 1.2 billion square feet (91.48 million sq m) of space, or roughly 40 square miles (103.6 sq km) of empty and abandoned stores and another 100 square miles (259 sq km) of unused parking lots. Retail rent growth is projected to decline by more than 5 percent in 2009 before recovering in 2010, and retail capital value losses may approach 20 percent. This catastrophe did not just happen because of the economic downturn or the housing bust that began in 2007, although these triggered it. The trend actually has been building for years and is only now becoming widely recognized.

A troubling new aspect is that much of the new vacant retail space is in newer shopping centers in outer suburban communities where housing construction has slowed dramatically—not in older obsolete space. The old rules that retail follows rooftops has become wildly distorted as retail development followed the anticipation of *future* rooftops—a future that is now greatly delayed or might never come at all in some fringe areas, not only because of the short-term housing bust, but also because of long-term demographic changes regarding where people want to live.

Unlike past experiences, the end of the current housing downturn may not be followed by another housing boom at the fringe—at least not like the fast upturn we have gotten used to. The market may not bail out bad decisions on the part of developers and communities anytime soon, because more and more people may look for alternatives to a large single-family house at the fringe that requires long, congested drives to the grocery store or to work when gasoline prices increase again and as our highway infrastructure continues to deteriorate.

Even if another boom does eventually start up at the fringe, the type of retailing (and housing) required will likely differ substantially from what was built there in the past. Isolated, single-use strip centers and stand-alone big boxes accessible only by automobile in distant locations will seem misguidedly quaint.

The intense competition among jurisdictions for commercial tax revenues is another cause of the problem. Communities often do not care that there is no *net* demand for additional retail space. When they zone too much land for retail or approve too many retail centers, they are interested primarily in ensuring an increasing commercial tax revenue stream for themselves to pay for the services that a burgeoning population requires. That their neighbor's older centers may go vacant is not of much concern.

This beggar-thy-neighbor approach has led to serious land use distortions that we have known about for years, but that we have so far failed to do anything about. It is easy to say that communities should cut back on the land they zone for retailing and stop approving so many unneeded shopping centers, but this will require state involvement regarding regional planning and taxation policies to succeed

What communities can do is to reorient their retail development regulations to create more sustainable retailing patterns. Communities must demand sustainable mixed-use development, higher commercial de-nsities, green leasing, more redevelopment of obsolete spaces, and retail centers that make sense regionally as well as locally.

The world has changed fundamentally, and the current crisis should be a wake-up call for us to step back and address the serious shortcomings of our present retail land use and development policies, which have led to the industry's current overbuilding, obsolescence, and financial disaster. Otherwise, we will simply be laying the groundwork for the next destructive boom-bust retail cycle, and our goal of creating more livable and sustainable metropolitan communities will slip that much further away. UL

MICHAEL BEYARD is a senior resident fellow at ULI and ULI/Martin Bucksbaum chair for retail and entertainment.

The Retail Bubble

Michael Beyard in Urban Land, January 2009

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The Retail Bubble

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