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Investors Tap Cash on the Sideline as Sales Velocity Begins to Rise

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The stockpile of capital that investors have been accumulating may finally start to shrink as investment in retail real estate picks up.

Industry experts have tossed the �cash on the sidelines� phrase about so often during the last few years that the supposed mountain of money has taken on almost mythical proportions. Even though the exact dollar amount is difficult to pinpoint, brokers say it easily adds up to tens of billions of dollars�or more.

Investors across the board, from public and non-traded REITs to private buyers, pension funds, life insurance companies and foreign investors, have amassed significant war chests since the market crashed in late 2008.

In 2009, investment sales volume ground to a halt, but volume slowly built up throughout 2010. In the fourth quarter, **nearly $8 billion in retail properties changed hands**�the highest level recorded since the market crashed. Overall, retail sales during 2010 totaled $22.6 billion. It�s a step in the right direction, even if it amounts to just 27 percent of the $83.4 billion in retail real estate that sold in the industry�s peak year of 2007, according to New York-based real estate research firm Real Capital Analytics. (The firm tracks sales transactions valued greater than $5 million.) But observers expect that **volume will rise** in 2011. The **most bullish predictions** are that volume could double 2010�s total. That would put the industry on par roughly with 2004�before things got out of hand in the bubble years.

Centers with high occupancies to good tenants remain the most sought after by investors.

Institutions, funds and even private buyers have continued to accumulate capital over the past two years from both equity and debt sources as they restructured debt, cleaned up balance sheets and continued to raise funds from individual investors and stock offerings. As the prospects for the sector improve, equity targeting retail assets will increasingly step into action as investors exhibit a growing appetite for real estate and an increased willingness to assume risk. Demand has returned along with a consensus that the retail sector is near the bottom.

�I think people are starting to feel like the light at the end of the tunnel is not a train,� says David Birdsall, a senior vice president at Cincinnati-based Phillips Edison & Co. And Phillips Edison is positioning itself to be one of the firms that steps into the light first. The company plans to raise $1.5 billion in public money over the next three years through its non-traded REIT, the Phillips Edison ARC. Phillips Edison has also launched Strategic Investment Fund II last October, and the private fundraising initiative has already raised $35 million towards a $100 million goal.

Cash on hand

Pinpointing exactly how much capital that is poised to strike is a difficult proposition. Some parts of the market are more transparent than others.

Publicly traded REITs, for example, are **flush with cash** thanks to the success the sector has had in raising capital from both debt and equity sources. That fundraising prowess is due largely to the strong recovery in REIT stock prices after stocks hit bottom in early 2009. U.S. retail REITs raised about $9.6 billion in capital through the debt and equity offerings in 2010�a 14 percent increase over the record $8.2 billion the sector raised in 2009, according to data compiled by Jones Lang LaSalle and Bloomberg. In addition, there were several REIT IPOs in 2010 and **more in the works** for 2011.

REITs are also in a stronger financial position today because they have spent the past two years cleaning up their balance sheets. Houston-based Weingarten Realty Trust, for example, has implemented a number of capital strategies over the past two year, such as renewing its bank line of credit, completing a bond offering and initiating two secured financings. The result is that the firm has dropped its leverage to 45 percent and reduced its 2011 loan maturities by about $1 billion. In addition, the company has access to a $500 million line of credit�the vast majority of which is untapped. �Frankly, we have a tremendous amount of capital. The issue for us is finding opportunities that make economic sense to deploy that capital,� says Weingarten CEO Drew Alexander.

Public non-traded REITs also are sitting in a strong cash position. Effective non-traded REITs raised an estimated $5.7 billion during the first three quarters of 2010 and **closed and effective REITs combined are sitting on $3.1 billion in cash and equivalents**, according to data from Blue Vault Partners LLC.

Foreign investors are bringing even more capital to the table with a resurgence in demand for U.S. retail properties. In fact, foreign real estate investors are more bullish on U.S. real estate today than at any time in the past decade. According to the 19th Annual Foreign Investment Survey conducted by the Association of Foreign Investors in Real Estate (AFIRE), more than 60 percent of respondents said that the United States is the country that offers the best potential for capital appreciation.

That is the highest level since the survey question was first asked in 2000. In addition, 72 percent of respondents say they plan to invest more capital in the U.S. in 2011 than they did in 2010. Although apartments rated first, foreign investors tabbed retail as their second choice among property sectors they would like to buy in the U.S. in the coming year. Kimco Realty Corp. is one REIT that is tapping into that growing foreign demand for retail properties. Kimco formed a joint venture relationship with Israeli-based BIG Shopping Centers in 2010. The two companies now jointly own some 22 properties together totaling 3.5 million square feet.

Cole Real Estate investors paid $31 million for the Volusia Square shopping center in Daytona Beach, Fla., in racking up $2.5

�I think that is indicative of an appetite from foreign investors generally who want to invest in U.S. real estate,� says Scott Onufrey, a senior vice president at Kimco, which is based in New Hyde Park, N.Y. Kimco also has access to equity through its partnerships with about two dozen different institutional investors. �We buy a lot of properties with partners, because they are a good source of equity capital,� Onufrey adds.

Lastly, there is a considerable amount of cash in private hands waiting to strike. It is difficult to pinpoint exactly how much is out there in these dark pools. But industry insiders believe that private investors may have the biggest pile of cash of all.

Anecdotally, Hessam Nadji, managing director of research and advisory services for Marcus & Millichap Real Estate Investment Services says, �We know that it is significant. The way I gauge is it from inquiries about consulting work [and] people coming to us asking for advice in picking markets and picking assets. I can tell you that we have had more of those inquiries in the last 18 months than in the previous 10 years.�

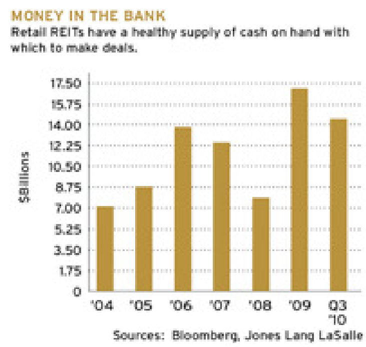
All told, it makes for an impressive amount of capital looking for deals.

billion in acquisitions in 2010.

Pent-up demand continues

Part of what�s kept so much cash on the sidelines up to now is that investors have been waiting for values to stabilize and more attractive buying opportunities to emerge. For a long stretch, it wasn�t clear how much retail assets should be trading for. So much of the activity has been on core assets, where supply has been limited.

�There has been such little core product introduced to the market that the capital hasn�t dwindled much,� says Kris Cooper, managing director of Jones Lang LaSalle retail investment sales practice in Chicago.



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Today, however, buyers are increasingly considering assets lower down the value chain. There was a rise in demand for such assets in the fourth quarter and that interest will increase in 2011.There has also been a steady stream of acquisitions in the pure distressed market as banks and special servicers offload their worst properties.

In addition, the financing picture continues to improve as banks, life insurance companies and even **conduit lenders** have become more comfortable in lending on retail deals.

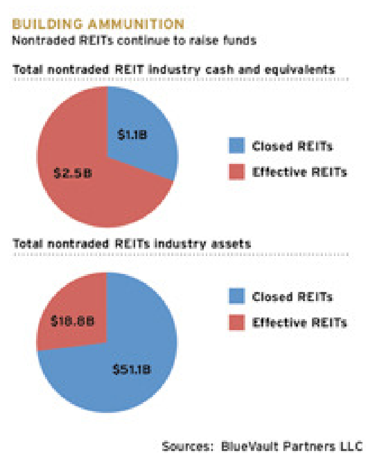
Another factor that should increase activity is the fact that **retail fundamentals are stabilizing**. Vacancies on both shopping centers and malls stopped rising in the second half of 2010, according to New York City-based real estate research firm Reis Inc.

The company still thinks the vacancies among neighborhood and community centers may tick up a bit from the current level of 10.9 percent to reach 11.2 percent by the end of the year. But most of the worst is behind and in 2012 the picture should decisively improve. Moreover, the decline in effective rents appears to be tapering.

Meanwhile, the situation is even better with regional malls. Vacancies have already begun to fall from a peak of 9.0 percent and expected to decline to 8.5 percent by the end of 2011. In addition, rents will rise a slight 0.2 percent in 2011.

Competition for core

Still, the big institutional investors�life insurance companies, pension funds, REITs and foreign investors�remain focused on quality properties in major markets. �Those investors have plenty of capital, and they have not found homes for a lot of that cash,� he adds. And those buyers becoming more active in 2011 will find themselves in competition with firms that have been busy even during the industry�s down years.



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Companies such as Phoenix-based Cole Real Estate Investments have continued to raise and deploy capital throughout the recession. Cole, which operates several public nontraded REITs, invested $2.5 billion in 2010 alone, and the company anticipates spending even more in 2011 with a goal of completing between $2.5 billion and $3 billion in acquisitions. Cole typically targets class-A properties anchored by leading grocers and tenants such as Kohl�s, Walmart and Walgreen�s.

For example, Cole recently purchased the Volusia Square shopping center in Daytona Beach, Fla. for $31 million. The 228,139-square-foot center is 96 percent leased. Investors such as Cole are hoping that a better balance between the supply and demand for retail properties will create a more stable investment market in 2011. �There is going to be more competition, but I also think there is going to be more product on the market,� says Thomas W. Roberts, president, real estate group, at Cole Real Estate Investments.

The increasing competition and limited supply of top properties listed for sale has made it more difficult for buyers to win transactions. �I don�t know if it is as competitive as 2006, but there are multiple, multiple bidders on any property of any quality,� Alexander says. In addition, borrowers who are seeking loans on best-in-class properties are finding very attractive mortgage rates that make the leveraged buyer very competitive, he adds.

additional analysis

Chasing higher yields

Intense competition for core properties is prompting buyers to pursue value-opportunities that generate higher yields. Cap rates are as low as 6 percent for class-A trophy assets and range to more than 10 percent for non-core distressed shopping centers, according to Jones Lang LaSalle.

Kimco expects to invest about $250 million in new assets in 2011, and has already closed on $56 million in new retail properties in January. The company is focused on acquiring high quality, core assets that also include a value-added component.

For example, Kimco recently purchased the Shops at District Heights, a 91,000-square-foot grocery-anchored center in Washington, D.C. The newly constructed project was still in the midst of its lease-up with an 86 percent occupancy rate at the time Kimco bought the property in late 2010. �We view the opportunity to lease up those vacancies as a value-add for the portfolio,� Onufrey says.

Philips Edison is also targeting opportunistic investments with its Strategic Investment Funds I & II. Both funds focus on properties within the non-grocery sector such as power centers and lifestyle centers that are in need of joint venture equity or rescue capital. The Strategic Investment Fund I recently purchased the note on a 300,000-square-foot shopping center in Fort Smith, Ark. that is shadow anchored by Target.

�The good buys are going to be on the truly broken stuff that needs a fixer. It�s not going to be on the stabilized stuff, because the cap rates haven�t floated that much,� Birdsall says. �It�s the real ugly stuff that needs an operator who can come in and run centers, that will benefit.� Strategic Investment Fund I is expected to deliver a 16 percent return to investors.

Buyers remain selective

A surge in fourth quarter transactions is a positive sign that sales velocity is improving. The closing of the $2.3 billion sale of Prime Outlets to Simon Property Group helped to elevate fourth quarter retail sales to $7.8 billion�up 30 percent compared to the $5.9 billion in sales that closed in third quarter.

Predictions vary for what to expect in 2011 as capital comes off of the sidelines. Cooper thinks volume may rise modestly. �That recovery in the sales market will occur gradually throughout 2011 and 2012 and into 2013,� Cooper says.

Marcus & Millichap, meanwhile sees activity rising by 30 percent. Real Capital is the most bullish of all and **says that volume might even double 2010�s total**.

Yet even as investors are feeling pressure to deploy capital, they are still focused on making prudent choices given the many challenges that remain in the retail market.

�You can�t just put together an academic check list that says you want to buy a shopping center with the top grocer in the market, the top sales and a good demographic area, and then just go in and write the biggest check,� Alexander says. �I don�t think you can do that and make money for your shareholders.�

So although the supply of for-sale properties is expected to increase in 2011, buyers focused on top tier properties may continue to be frustrated by the stiff competition for core shopping centers.

Until cap rates go down to levels that they were�either at or near the peak of the market, a lot of institutional sellers don�t necessarily want or need to sell. �While investors are dying to buy properties, they are not willing to put their own assets on the market,� Cooper says. �So it is really a Catch-22.�