Real Estate New York assembled some of the leading executives in the retail industry at the Penn Club for a Pulse of the Market panel discussion. Panelists were: Moderator **Joseph C. French, Jr.**, CCIM, national director of retail properties for Sperry Van Ness; **Stephen Ifshin**, chairman, DLC Management Corp; **Leo Ullman**, chairman, CEO of Cedar Shopping Centers, Inc.; **Josh Podell**, vice president of real estate, Jones Apparel Group; **Patrick Breslin**, president of the East Coast Retail Group for Grubb & Ellis; **Dan Fasulo**, head of research for Real Capital Analytics Inc.; and **Gardner B. Semet**, administrative vice president commercial real estate–New York City for M&T Bank.

FRENCH: *Are you optimistic or pessimistic about the economy? Do you think the current recession will be short-lived? And when do you see the capital markets returning to normal?*

ULLMAN: I don't know that I'm the expert in this area because I wrote an article for a Dutch publication not too long ago predicting that the subprime crisis would be localized and contained and we'd survive that easily and comfortably. So I'm not sure that I'm the one to speak to on this issue. But in my view, in respect to our centers, which are primarily supermarket-anchored products in the Northeast, we feel that the timing of the consumer problems is going to take a couple of years anyway. We think that the credit constraints will be solved over a shorter period. Somehow, the CDO and CMBS backlogs will be washed out of the balance sheets where they are being held at this point because of the government intervention, and because of greed setting in, ultimately, at some price. But I do feel that the consumer problems will continue for some time because the housing situation, the consumer confidence level and the disposable income issues are going to be out there for quite a while.

PODELL: Those of you who were here last year may recall that I made two predictions. First, oil was going to come down substantially, and next, we were going to stay out of a recession. Well, one of them came true. I had mentioned that since this was an election year, the government was going to do everything possible to keep us out of a reces-

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sion, and I believe that is happening. Having said that, I am "less than optimistic"—I think that is probably the most politically correct term I can use, about the economy.

I think we are – from a retailer's standpoint – entering somewhat of a Darwinian period for retail in this country. There used to be, in my mind, a real place for the solid number two retailers in each category, ie. the Circuit Citys and the Linens-N-Things of the world. I'm not sure that this still holds true. I think that this is already starting.

I hope it doesn't continue that long, and I believe that by this time next year we're going to start to come out of this for a variety of reasons. I think we're in for a rough 12 months, however.

BRESLIN: We all thought that the economy was going to be a little localized, maybe in the northeast. But then, speaking to people around the world, it's no different in the UK and in China and in Russia and places like that. Everybody's feeling the same effects that we're here feeling right now. So, am I optimistic, I'm always optimistic. But I have to be a little bit of a pessimist because I really think we're going to be in for a very, very hard ride for 12 to 18 months, minimum.

IFSHIN: I think that the economy will be on a downside for the next six to nine months. And we envision some consumer spending re-entering the marketplace after the summer. It's going to be a very difficult period of time for retailers. We're seeing that now. I think only the strong will survive. There will clearly be a further shaking out of retailers. I don't think we've seen the final deleveraging of the private equity effect on retailers that were bought by private equity shops. They're all at risk, and they will cause all of us problems if we have them in our portfolios.

We don't see the credit markets coming back to resemble anything like it used to be. We think that it'll be many, many years before there's a quantitative change in what we used to know as a credit market in '04 '05, '06, and '07. It'll more resemble what it looked like in the 80s and early 90s, and very low leverage, a lot of capital, and it will only be responsive to good reliable sponsors with solid equity.

SEMET: I think the capital market will slowly work its way out. The government fixed the intermediaries and now we have to work on the housing market to help the consumer. Working our way out of the housing crisis would avoid problems from the maturity of CMBS loans and shorter term loans generated in 2006 and 2007 by Wall Street lenders.

FASULO: I'm definitely not an economist, but in light of the uncertainty in the market right now, I think it's just really difficult to stay optimistic, between the severe troubles in the financial markets, the uncertainty regarding the election and whether an administration is going to come in and change the rules all over again. I think it's going to be a while before investor confidence comes back to the market.

You know, the wild card is really going to be how severe and long a potential recession is. We still haven't see the other shoe drop, which would be fundamentals deteriorating and having a real significant impact on NOIs. There is definitely been some high-profile bankruptcies and space reductions by some of the national retailers, but I think overall we're in pretty good shape, especially in some of the supply-constrained markets here on the coast. But investors certainly are cognizant of slowing consumer spending and the impacts it may have on their real estate. Many I speak with every day are very concerned about this and feel that prices haven't softened enough to make them comfortable jumping back into the market, given all the uncertainty right now.

As far as the capital markets returning to normalcy, I really think it's going to take a while for the deleveraging process to really work its way through the markets, even with the trillions of dollars worth of capital being flooded in by all these governments around the world. The trick's not going to be just buying the bad assets from banks and infusing them with capital, but getting banks to get out there and loan again.

FRENCH: *How is the credit crunch affecting your company, where do you see the growth going forward, and what has your company done to put capital to work, given these conditions?*

PODELL: I do not believe credit has affected our company. We are a cash-rich company, with very low leverage with no short-term outstanding debt, so on a day-to-day basis, we are somewhat insulated from what's happening. Having said that, it affects us to the extent it affects the consumer, and everything that's happened to their credit and their buying power can potentially affect our sales.

As far as putting capital back into our business, again, from a real estate and construction standpoint, which is my world, we're not currently doing anything differently. For example, we're looking to implement a very substantial lease administration/lease management software system, which will cost several hundred thousand dollars. This is something that normally, in this type of economy, you wouldn't do if you had issues with capital. We're taking advantage of this because we see long-term benefits from the investment. So, again, day-to-day—other than sales and our customers—it's not impacting the way we're running our business.

IFSHIN: Well, we're not any different than anybody else. The credit crunch has affected our ability to buy centers.

As an example, in the last 12 months, ending in '07 December, we bought 35 shopping centers, 33 shopping centers with grocery anchors. We were able to finance them with commercial banks. And from January to today, we've bought one center, and we've got two under contract. So, clearly, the credit markets have affected our business.

However, there are other factors that credit affects. We have 96 centers and we have $1.5-billion worth of secured mortgage debt, and we spent the last couple of years staying away in the most part from interest-only mortgages and using amortization so that we feel we're positioned and protected from the credit markets going forward. In our current portfolio, in the next two years we only have $40 million worth of debt coming due in three centers. We have every expectation that we'll refinance those centers.

My sense of where we go with our money—and we have a fair amount of liquidity—to go forward is that we're looking to place our money in a number of areas other than buying shopping centers. We're looking to buy distressed debt. We'd rather be in the debt stack now than be out looking for unrealistic prices from sellers who clearly don't want to understand the situation we're in. We're deploying money in mezzanine financing with a group of what we call really smart investors, real estate people, along with ourselves, who understand how to price mezzanine financing and are looking for the proper locations.

SEMET: Although the credit crisis has driven up the cost of capital dramatically, which hurts, on at least our borrowing side, the most important measure of a bank's safety and soundness is its capital, which—to put it simply—is the amount by which assets exceed liabilities. M&T remains very well capitalized. Our estimated Tier 1 capital ratio as of Sept. 30, 2008 increased to approximately 7.91%, up from 7.76% as of June 30. In addition, we have very limited exposure to the high-risk assets that have created so many problems, so with or without this legislation, M&T Bank remains strong and steady. More than anything else, we're hopeful that they do something to stabilize the financial markets.

Lending margins have increased. There was a point, starting three years ago, when Bear Stearns was lending at 10-year treasures plus 75 basis points to 85 basis points, and we just could not compete there. So the current crisis has widened out the spreads and there's less competition. We are focusing on our clients, who have both borrowing and depository relationships with M&T.

We have also started syndicating larger credits, in advance of a loan closing. A lender has to syndicate when it can, because if you have to sell in this market—you just get crushed. If you're pressed for capital, because people know when you're pressed, they start smelling a discount. Advanced planning for the syndication of real estate loans is one of the more recent changes.

FRENCH: *Having money to lend in this market must make you a very popular guy?*

SEMET: It's good to be still lending today and we have made an effort to use all our resources, including placement of loans with Freddie Mac, Fannie Mae, FHA insured loans, syndications, direct loan placements with correspondent lenders and portfolio lending.

FASULO: We're in the information business, and business is booming. Investors can't get enough information about the market right now. And honestly, in more than 10 years as a real estate analyst, I've never been asked so many questions I don't know an answer to. It's been unbelievable. The credit crunch has been very democratic in its impacts, affecting all markets, all different types of investors.

Sales volume is off over the last four weeks. There were only 80 retail properties greater than $5 million that sold in this country in September. That's down from when we were averaging 400, 500, 600 a month in early 2007. The overwhelming majority of the assets are selling now in the $2-million to $20-million range. The mega deals we saw last year just aren't happening. And the few large transactions we've seen have been done with assumed debt or some sort of seller financing. I was actually with the Inland Group a few weeks ago and they were able to close on a property the week of the Lehman bankruptcy. So there are some players that are buying into this market, but all in all, we've seen transaction activity fall off a cliff.

ULLMAN: I think one of the things that is very important in this market is relationship banking. We have to work very hard to find debt, and I think relationships are extremely important in this market. For us, it's meant that acquisitions have become extremely difficult. If you're buying on the basis of cap rates and you're measuring cap rates against borrowing costs and equity costs, it just doesn't work.

Accordingly, our model has morphed a little bit into looking at leveraged cash returns, rather than looking at IRRs or cap rates going in, and we look at properties where there is some existing attractive debt with some term to be assumed. Those are perhaps the only acquisitions we could do. Also, like many other people in our business, we are looking to joint venture acquisitions, just to use other people's cost of money as a means of acquiring properties. We have found our real opportunities in this market to be some development properties, and, please note again, that our product is a little bit different from other retail property REITs.

We only develop, basically, when we have a supermarket anchor. Our properties are anchored primarily by supermarkets, and the supermarkets in this economy are doing quite well. For that product we see some very good opportunities throughout our northeast quadrant with small local developers who are financially stretched, who cannot source debt very easily, who've been able to get properties entitled, who've completed some meaningful pre-leasing, and who do not have the money to finish it off. We are able to come in there, get a very nice preferred return, get a good back-end profit, and put our money out on a very nice double-digit kind of return. For small, 100,000 sf, 120,000-sf centers with a 75,000-sf foot grocer, that's our product, and it works pretty well. In this market there are, and will be, some nice opportunities for us.

FRENCH: *How do you see the current economic environment impacting retailers, the demand for retail space, and rents?*

BRESLIN: The rents haven't slipped all that much, and in a lot of cases they haven't slipped at all in our immediate area here, 50 or 60 miles from Columbus Circle. What it is affecting is the deal structure; it's harder for landlords to come up with construction money for tenants. The banks' lending practices are just as hard for construction loans as they are for long-term debt on properties. The leasing portion—landlords who in the past have been quite strict with their guidelines to rental and construction allowances—are beginning to understand that if you have a retailer who is of pretty good credit as a credit risk, they're even looking at that now. I've had one very, very large landlord ask one of the largest public companies in the world for a security deposit, for the first time ever. And it didn't go over well.

There are retailers who still are very strong on their programs, who are out there, who are leasing space and building new space, and they were prepared for this type of market, and they're still bullish, a little bit. But it is making everyone take a step back, and take in a double look at just about every portion, every sliver of the deal that you're doing. Landlords want to save as best they can, and tenants want to save as best they can, as well. But New York is a tough place, and you can't judge New York by Chicago or Los Angeles or anything like that. It's just a different animal here. Rents are still very, very competitive here.

IFSHIN: When we saw this coming, we changed the way we do our leasing. We have always done all our leasing in-house, so the only people we've hired in the last nine months are more leasing reps. We've skinned down the centers that they're responsible for, so that we could get focused on less centers. We find that the development business has shut itself down... It gives us an opportunity to present space to some tenants that we've never had an opportunity to bring our spaces to.

More than 85% of our centers are grocery-anchored convenience centers. A large concentration of our business is with retailers like Ross Dress For Less, A.J. Wright, TJ Maxx, Marshall's, Dress Barn, Harbor Freight, Dollar Tree, Family Dollar, a lot of gyms, and a lot of alternative uses. And I think that in this economy, in this kind of credit market, you have to do business with what presents itself to you. My centers are 94% leased. We find the leasing volume across 23 states is uneven, but in general the volume of new leases, in my estimation, in this market, is quite good, actually better than we expected.—RENY

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Patrick Breslin, a 23-year industry veteran, is president of the East Coast Retail Group for Grubb & Ellis' New York operation. He focuses on retail brokerage services and new retail business development nationally and internationally.

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