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Location, Location, Location ... LOCATION!

The disparity between the best locations and the rest is very wide

While multifamily assets have always been the product type most demanded by the investing community in New York City, retail properties are gaining traction.

Robert Knakal

With the International Council of Shopping Centers' East Coast conference returning this week, it's an appropriate time to check in on how retail is doing in New York.

The retail sector has been on quite a roller coaster ride since the height of the recession in 2009. During the asset-bubble-inflating years of 2005 to 2007, almost any retail asset in Manhattan would trade at around a 5 percent cap rate. In other submarkets, the cap rates were 100 to 250 basis points higher on average. These low cap rates were available to sellers regardless of the credit quality of their tenants. Whether the space was leased to "Sam, Sam the Discount Man" or an AAA credit retailer, the cap rates were very low.

At the height of the recession, consumer confidence was at levels lower than they had been seen since this statistic was monitored. Consumer spending, consequently, dropped like a stone, significantly impacting the performance of rent-paying tenants and in turn affecting the rents they were willing to, or could afford to, pay. The impact on retail property yields was felt immediately. By the time values hit bottom in 2010, retail cap rates were up about 250 basis points across the board. In the Manhattan submarket, the average cap rate hit an unheard-of 7.44 percent.

When discussing average cap rates by submarket, it is important to recognize that cap rates can vary greatly within each submarket. This is true for all product types, but this dynamic is magnified in the retail property sector.

Since the 2010 low point, the retail market has made a remarkable comeback, but demand is currently not nearly as even as it was at the market's previous peak. Presently there is a huge disparity between different classes of retail properties. Class A properties in A locations with good-quality credit tenants are currently trading at record levels.

At the same time, retail properties in tertiary locations may have been sitting vacant for months and months, if not years. In some cases, even in Manhattan, ground-floor retail spaces, which have been vacant for far too long, are being converted to residential apartments. Owners feel that even though the rent per square foot may be a bit lower, the vacancy period between tenants is only a matter of weeks for apartments, rather than months, making the effective annual rent more attractive.

Notwithstanding this divergence within the sector, the better-quality assets are driving the market, particularly in Manhattan. There were 194 retail properties sold through the first three quarters of 2012 citywide, with 73 of the trades taking place in Manhattan. Brooklyn has the second-most sales at 53. The remarkable thing here is that there are nearly three times the number of properties in Brooklyn than there are in Manhattan.

With regard to the dollar volume of retail sector investment sales, it was nearly $7 billion citywide through the first three quarters. Eighty-five percent of this activity, or almost $6 billion, has occurred in Manhattan. This over-weighting of the Manhattan submarket is similar to what is observed in the office building sector each year. However, what really separates the submarkets is the average price per square foot obtained for retail properties.

In the Manhattan submarket, the average has been $1,488 per square foot this year, compared with $473 in Northern Manhattan (the 125th Street corridor is responsible for this ranking), $418 in Brooklyn, $379 in Queens and $246 in the Bronx.

The best locations are clearly appreciating very rapidly, while the areas that are considered secondary, tertiary or worse have found gaining traction challenging. Demand for these assets remains high, and we anticipate this continuing throughout 2013.

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