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Low Interest Rates Spearhead Uptick in Retail Investment Throughout Boston

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retail space within Vita, a luxury condo building in the Jamaica Plain neighborhood. Retail buyers are acting aggressively throughout Boston, especially within the private investor market.

By Taylor Williams

The business of trading retail properties is booming across the greater Boston area, and the combination of cheap capital, a desire to recoup lost business and potential changes in tax law are prompting buyers and sellers alike to transact at a frenetic pace.

As is often the case in times of robust investment sales activity, low interest rates are the straw that stirs the drink. At its latest meeting in June, the Federal Reserve opted to hold the federal funds rate — the short-term rate by which lending between financial institutions is priced — at a target range of 0 to 0.25 percent. The Fed cut rates by 100 basis points to this target range in March 2020 in response to the COVID-19 outbreak and has kept them there ever since.

A fiscal policy defined by record-low rates is persisting even in the face of inflation, which hit its highest mark in 13 years when the U.S. Consumer Price Index rose by 5.4 percent in June 2021 relative to June 2020. Economists have cited sustained injections of federal stimulus and relief money and elevated government spending in response to the pandemic as the key drivers of this trend.

Yet despite clear evidence of an inflated economy, the Fed has yet to play its trump card by raising rates. Retail investors are hustling to take advantage of this hesitation on the part of the nation's central bank.

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"Low interest rates are the grease that keeps the locomotive moving forward," says Jim Koury, senior managing director of investments at the Boston office of Institutional Property Advisors (IPA), a division of Marcus & Millichap. "Rates don't have to increase much for serious losses in asset value to be recognized. So buyers and sellers are both being opportunistic while they can. As a result, business is as robust now as it's been at any time in my 30-year career."

"Rates have held low, and with investors expecting the Fed to raise rates in 2023, a lot of transactions that would have happened in 2022 or 2023 are being reevaluated for this year," adds Bob Horvath, executive vice president at Horvath & Tremblay, a national brokerage firm based in metro Boston. "We're expecting a lot of private sellers to bring assets to market in the next few months."

Koury adds that unlike a year ago, investors are now armed with much better data on the impacts of COVID-19 on the retail sector. Within the Boston market, some of the hard numbers have served to dispel preconceived ideas about which subcategories of retail product were truly most vulnerable.

"By January, more data points had come in, and investors realized that some assets weren't in as bad of shape as previously thought," he says. "But cap rates still went up on paper at many of these properties. So buyers found opportunities in deals for properties with perceived risk and which saw their cap rates go up."

Buyers Get Aggressive

In Koury's view, several economic factors are

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augmenting good opportunities to buy — and sell — in the Boston retail market.

"Rates are still low, inflation hasn't fully kicked in yet and tax law changes are still pending," he says. "Both sides are being opportunistic in terms of these factors, but the difference lies in who's buying and selling. Many private sector buyers are targeting deals like power centers or centers in secondary markets that had perceived risk but have outperformed expectations, whereas many institutions are taking advantage of the market by selling retail prized as risk-averse at historically high pricing."

Horvath agrees that private buyers are being particularly aggressive in the current climate, particularly when compared with their institutional counterparts.

"Within the private client space, the investment sales market for retail product is as good as I've ever seen it," he says. "In terms of the buyer profiles, there are a lot of new buyers coming into the market — those that are new to the retail/net-leased world and are drawn to distressed assets — as well as 1031 capital that's coming into the net-lease space from other asset classes."

Horvath also notes that while some new trends have recently emerged in the Boston retail investment market, others that were established in the earlier stages of the pandemic are still entrenched. These include a flight by investors to high-quality assets, a preference for tenant rosters that are heavy on essential business and a push to close 1031 deals prior to potential legislative changes.

"Investors are looking for quality tenants with good credit and term on the lease, and when that product comes to market, it moves very quickly," he says. "Multi-tenant retail deals are moving fairly well, but demand in the net-lease space is also as strong as we've ever seen it."

Horvath & Tremblay recently arranged the $11 million sale of a newly built retail property in the northern Boston suburb of Woburn that was leased to Walgreens. The deal traded at a cap rate of 5.37 percent.

By the Numbers

The trend of elevated retail sales is happening on the national level. For all the talk about how the pandemic has irreparably shifted shopping habits away from brick-and-mortar stores to e-commerce, investment in retail properties of virtually all types is on the rise in 2021.

According to the latest data from Real Capital Analytics (RCA), U.S. retail investment sales volume for the second quarter totaled $13.7 billion, a staggering year-over-year increase of 154 percent. Investment sales growth was healthy in terms of deals for both retail portfolios (323 percent), multi-tenant centers (243 percent) and single-tenant assets (139 percent).

The RCA report noted that although the second-quarter volume still fell 26 percent below the quarterly average for the five-year period preceding the pandemic, the triple-digit growth was not the result of just a handful of large-scale transactions. In addition, the average price for U.S. retail assets rose by 3.2 percent year-over-year in the second quarter, which last happened in the fourth quarter of 2019.

However, the average cap rate for U.S. retail properties only decreased by 10 basis points between the second quarters of 2020 and 2021. The discrepancy between the magnitude of the increase in average price versus average cap rate in the retail sector suggests that inflationary pressures are contributing to price appreciation along with stabilized cash flows and occupancy rates.

Boston ranked as the No. 6 market in the country for retail investment in the RCA report, eclipsing its previous high ranking of No. 9. However, that ranking comes with an important caveat: More than a third of all retail sales in the Boston area were acquired with plans to redevelop the property into a different use.

This trend was perhaps best embodied in the $130 million sale of the Watertown Mall — also the market's largest retail deal of the second quarter. The buyer, Alexandria Real Estate Equities, intends to convert the property into a life sciences campus.

According to RCA's second-quarter report, through the first half of the year, the Boston market has posted $530 million in retail investment sales volume, an 87 percent increase from that six-month period in 2020. Forty-three properties have traded hands at an average price of $376 per square foot and an average cap rate of 5.6 percent.

1031 Concerns

To be sure, pent-up demand from investors, high levels of liquidity in the capital markets and the full reopening of business in Massachusetts (as of May 29), have also contributed to healthy deal volume.

In addition, sources say that investors are compressing their timelines to close on deals in anticipation of changes to the tax code, especially the section that deals with 1031 exchanges for like-kind properties.

"There are sweeping changes happening on the tax front that could impact everyone in the business, and that's driving a lot of the deals — investors wanting to defer taxes via a 1031 before the law changes on that," says Horvath.

"We're excited about the aggressiveness with which the investment community has responded through their retail allocations," adds Koury. "But we're concerned that if the 1031 provision is abolished, it would put an enormous damper on the amount of transactions happening in the market."

Leasing Activity

Across all subcategories of retail, leasing activity in Boston mirrors that of investment in the sense that there is confidence and aggressiveness underpinning a number of deals.

"It's not just one industry that's picking up; everyone in every industry is getting out and getting back to normal now," says Kerry Dowling, senior vice president of leasing at Boston-based development firm Wilder. "Tenants that put plans on hold during the pandemic are returning to normal operations and expansion plans. Supermarkets, drugstores, boutique fitness concepts, fast-casual restaurants with drive-thrus and outdoor seating are all seeing strong returns to the marketplace."

Corey Bialow, founder and CEO of metro Boston-based brokerage firm Bialow Real Estate, says that the initial rollout of COVID-19 vaccines served as a watershed moment for retail and restaurant users to resume growth initiatives.

“When vaccines became available, for the first time in almost a year, retailers and consumers felt there was finally an end in sight,” he says. “This created a lot of positive momentum in the Boston market. The driving force behind many of these deals was the restaurant industry, because for the first time in decades, there was an abundance of quality spaces available at more affordable rates.”

Sources agree that open-air lifestyle centers in suburban submarkets are generally leading the comeback in Boston.

“The downtown area, wherein retail relies primarily on the office commuter, will continue to struggle comparatively because of the structural demand changes to office space,” says Brian Cosentino, vice president of acquisitions at Wilder. “But live-work-play neighborhoods are already seeing recovery and will continue on this path. Like all previous recessions, suburban retail properties that are well-anchored outperform most other product types.”

“In suburban markets, the pendulum is swinging back into favor of landlords at the most dominant centers in a trade area,” Cosentino continues. “Retailers continue to be attracted to the best centers in a trade area, and they will relocate if there is an opportunity to upgrade.”

Bialow says that landlords continue to employ creative lease structures such as those that became popular in the early days of the pandemic. These include calculating rent as a certain percentage of sales or featuring a reduced rent at present with the option to convert to a market rate in subsequent years."

"This is a win-win because it provides tenants with a break upfront while the pandemic comes to an end, but it also provides landlords with confidence that over time, they can return to profitability with stable, consistent cash flows," he explains.

— *This article originally appeared in the June/July issue of* Northeast Real Estate Business *magazine.*

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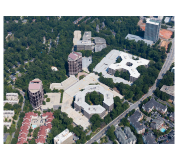

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