THE PROPERTY REPORT

DEAL OF THE WEEK | *By Maura Webber Sadovi*

Shopping Centers Anchored by Groceries Hold Drawing Power

The $62.1 million sale of a clutch of Midwestern shopping centers has underscored one of the truisms of recession real estate: Grocery-anchored shopping centers hold up well compared with other property types.

After all, people still need to eat. So while sales are way down at malls, luxury stores and apparel retailers, parking lots are still filling up at strip centers with grocery stores, and that's also benefiting the neighboring merchants.

This was clearly on the mind of several principals from **LANE4 Property Group**, a closely held Kansas City, Mo.-based real-estate company, which teamed up with other area investors last week to pay **Highwoods Properties Inc.** the $62.1 million, including debt, for about 416,000 square feet of neighborhood retail centers in suburban Kansas City. Raleigh, N.C.-based Highwoods, which put the properties up for sale in February, said it wanted to avoid more than $3 million in needed building improvements and to use the proceeds to pay down a revolving line of credit.

About a half-dozen bidders competed for the properties, an unusually high number in this market. The demand reflected bidders' belief in the drawing power of the three supermarket anchors, all Hen House grocery stores. "There's no way we would have gotten six bids without grocery anchors," says Mark De Riemer, senior vice president with Savills LLC, who represented Highwoods in the deal.

Like many grocery-anchored shopping centers throughout the country, the three properties appear to be holding up in the difficult economy. They have an overall vacancy rate of about 5.5%. That's well below the average retail vacancies in Kansas City metro's neighborhood and community-shopping centers, which rose to 13% in the first quarter from 8.6% in the year-earlier period, according to Reis Inc., a New York real-estate research firm. Tenants include a few national retailers like Macy's but are largely locally based retailers such as Bruce Smith Drugs and Rainy Day Books.

Despite the relative strength of grocery-anchored retail, LANE4 still bought at an attractive price. The properties generate net operating income of about $5.4 million a year. That translates into a so-called capitalization rate of about 8.7% on the deal. Cap rates are closely watched valuation metrics in the commercial real-estate industry derived by dividing a building's net operating income by the price paid. The rates have been rising steadily as the market has gotten worse. Two years ago, similar properties would likely have traded for cap rates in the 6% range, estimates Jeff Berg, senior vice president of LANE4.

Another sign of the properties' health was the buyer's success at securing financing, often a Herculean task in the current market. The deal was financed with loans from Bank of America and an unidentified life-insurance company. An unidentified individual also provided a temporary loan until the life-insurance loan is finalized, and equity in the project comprised less than 25% of the total purchase price, say people familiar with the transaction.

To be sure, grocery-anchored shopping centers aren't immune from consumers' budget cuts. Though supermarkets haven't seen the mass closings that home and apparel retailers have, consumers are buying lower-cost items, and wholesale clubs have taken high-margin paper-goods sales away from grocers, says Suzanne Mulvee, a real-estate strategist with Boston-based Property & Portfolio Research Inc. Moreover, owners of grocery-anchored strips are struggling with requests for rent concessions and with a rise in vacancies related to smaller retailers like pizza shops and nail salons going dark, she says.

The Fairway Shopping Center in suburban Kansas City, Mo., was part of a portfolio of properties that recently sold for $62.1 million.

Still, by some measures, supermarket-anchored centers are outperforming other retail properties. The dollar volume of sales of grocery-anchored retail centers valued at $1 million or more in the U.S. fell 39% in the first quarter to $352 million from about $581 million a year earlier, while sales of all retail properties fell 71% to $2.9 billion, according to Marcus & Millichap Real Estate Investment Services.

"Relatively, grocery-anchored centers are doing better," says Bernard Haddigan, managing director of national retail for Marcus & Millichap. "The capital markets are going toward safer bets, and the safer bets are necessity-based retail."

While suburban shopping centers aren't valued for their age, all three of the properties in the Lane4 deal clearly have demonstrated staying power. Fairway Shopping Center was developed in the 1930s; Prairie Village Shopping Center was built in the 1950s; Corinth Square Shopping Centers, treated as two properties by some, were built in the 1950s and 1960s. They were built by a company led by Jesse Clyde Nichols, one of the founders of the Urban Land Institute and an early proponent of using master planning in mixed-use commercial developments. The retail buildings, many of them brick, were designed to be part of his larger pedestrian-friendly communities.