# NATIONAL REPORT

Marcus & Millichap

RETAIL

2Q/24

## Retail Retains Status as the Least Vacant Property Sector as Strong Fundamentals and Consumer Resiliency Help Brace Against Potential Headwinds

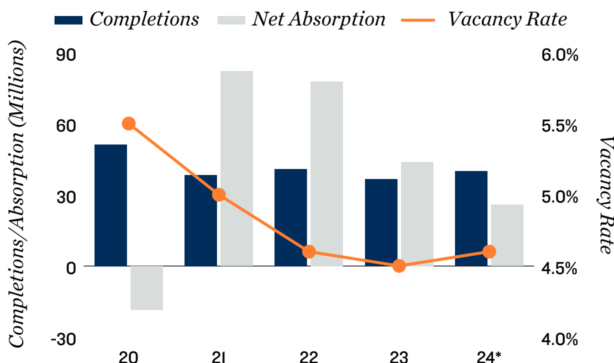
**Greater foot traffic and easing inflation lift outlook.** The retail sector was the only major commercial real estate property type to note vacancy compression over the yearlong period ending in March. Consumer resiliency is fueling steadfast tenant demand for space. Core retail sales rose 2.9 percent in the first five months of 2024 when compared to the same period of 2023. Over that span, restaurants, supermarkets, discount stores and fitness centers all noted 5 to 9 percent year-over-year gains in foot traffic. A strong labor market — 1.24 million jobs added over the first five months of 2024 — has aided households' buying power, fueling the increases in spending and patronage. Should these trends continue, and inflationary pressures ease further from May's three-year low annual core CPI rate, demand for space will be strong amid a period of limited construction.

**Widespread demand evident.** Among property types, multi-tenant vacancy was at a record low in March, with single-tenant vacancy just 10 basis points above its all-time bottom. Tight conditions are also prevalent across geographies, with broadly low vacancies nationwide. Among the 50 major retail markets, 34 ended March with a single-tenant vacancy rate at least 100 basis points below their long-term mean. Across these same markets, 27 exhibited sub-5 percent multi-tenant vacancy, a longer list than from the same period five years ago. With vacancy limited, construction is warranted; however, 30 major markets will record stock growth of less than 0.5 percent in 2024. As such, property owners in search of tenants are in a favorable position.

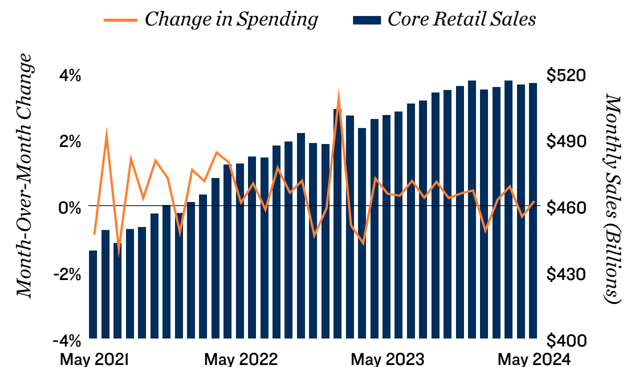
**Potential bulk disposition would impact group of property owners.** In early June, Dollar Tree announced it is considering a sale or spin-off of its discount-focused Family Dollar chain, which includes 7,300 stores. While no timeline was given, the execution of these strategies would create several scenarios for property owners with stores slated for disposition. Owners with stores pinned for sale could see the credit quality of their tenant improve. Shopping center and net-lease owners with stores slated for spin-off, meanwhile, would see their circumstances adjust nominally, unless stores were closed by the newly formed company. If listed for sale, Family Dollar locations could be acquired by several different parties in bulk — similar to Dollar Tree and Ollie's Bargain Outlet acquiring the rights for clusters of 99 Cents Only Stores in May.

**A significant volume of capital awaits deployment.** Tight vacancy, record asking rents and resilient consumer spending should continue to draw investors to retail listings. Contrasting some other commercial real estate segments, the availability of higher yielding assets and steady property valuations — with average retail pricing adjusting nominally over the past 12 months ending in March — should also broaden the buyer pool. Investors with an appetite for low-7 to 8 percent cap rates may pursue grocery-anchored properties and power centers. More hands-on buyers can obtain higher yields for unanchored centers, while buyers seeking less management-intensive assets that provide long-term stable income focus on net-leased assets.

### Retail Supply and Demand




### Sales Historically High, but Growth Slowing




** Forecast*

*Sources: Marcus & Millichap Research Services; CoStar Group, Inc.; Federal Reserve*

## Smaller-Midsize Centers Attract Tenants

| Property Type | Vacancy Rate* | T-12 Net Absorption** | Y-O-Y Asking Rent Change* |
|---|---|---|---|
| Strip Center | 4.3% | 3.5M sq. ft. | 2.4% |
| Comm.-Nbhd. Center | 5.8% | 16.0M sq. ft. | 4.6% |
| Power Center | 4.2% | 2.0M sq. ft. | 0.1% |
| Lifestyle Center | 4.9% | 1.5M sq. ft. | 1.9% |
| Outlet Center | 4.8% | 384K sq. ft. | 1.5% |
| Regional Mall | 9.4% | -1.2M sq. ft. | -10.0% |

## Available Net-Lease Space Still Limited

| Property Type | Vacancy Rate* | T-12 Net Absorption** | Y-O-Y Asking Rent Change* |
|---|---|---|---|
| Restaurant | 3.8% | 1.7M sq. ft. | 2.4% |
| Supermarket | 2.2% | 3.3M sq. ft. | 9.7% |
| Department Store | 6.4% | -449K sq. ft. | 14.5% |
| Fast Food | 1.3% | 1.4M sq. ft. | 5.7% |
| Drug Store | 3.1% | -1.9M sq. ft. | -9.8% |
| Convenience Store | 1.1% | 1.7M sq. ft. | 1.4% |

## Broad Rise in Foot Traffic Backs Growth

| Store Type | Y-O-Y Foot Traffic Change*** | Brands' 2024 Expansion Plans |
|---|---|---|
| Grocery | 5.7% | **Aldi** (Acquired Southeastern Grocers. Will convert 50 Winn-Dixie or Harveys Supermarkets locations to ALDI stores in the second half.)<br>**Sprouts Farmers Market** (35 new stores)<br>**Trader Joe's** (24 new stores) |
| Fast Food-Quick Service | 1.5% | **Jersey Mike's** (350 new stores)<br>**Chipotle** (285 to 315 new stores)<br>**Raising Cane's** (90 new stores)<br>**Shake Shack** (80 new stores) |
| Discount | 8.9% | **Dollar Tree** (Purchased 170 former 99 Cents Only Stores; exploring sale of Family Dollar)<br>**Dollar General** (800 new stores)<br>**Five Below** (225 new stores)<br>**Ollie's Bargain Outlet** (50 new stores; purchased 11 former 99 Cents Only Stores in May) |
| Restaurant | 6.4% | **Texas Roadhouse** (30 new locations)<br>**Outback Steakhouse** (18 new locations) |
| Department | 0.02% | **Burlington** (100 new stores)<br>**Ross Dress for Less** (90 new stores) |
| Fitness | 4.8% | **Planet Fitness** (140 to 150 new locations)<br>**Crunch Fitness** (Increasing growth rate by 20 to 25 percent) |

## Expansion Initiatives Limit the Impact of Upcoming Store Closures

**Candidates in place to backfill spaces of various sizes.** A round of drug store, big-box and restaurant closures are lined up for the second half. Fortunately for impacted property owners, a diverse group of retailers remain in expansion mode. This and leasing data from the past 18 months indicate most soon-to-be vacated spaces will attract a pool of potential, higher-credit suitors — demand that will minimize these closures' impact on vacancy. Grocers, fast food chains, discount stores and off-price retailers headline the cohort of companies likely to backfill these spaces; however, other tenants will vie for these storefronts. Pickleball franchises have collectively leased more than 2 million square feet nationwide since the onset of 2023. At an average of nearly 30,000 square feet, these commitments have played a notable role in removing big-box spaces from the nation's vacant stock. The Picklr and PickleRage are among the expanding companies, with the latter planning to open 500 locations in the next five years. Other fitness-related tenants, primarily gyms, signed over 700 leases — averaging 11,500 square feet — over the past 18 months, aiding owners with mid-size vacancies. Those with smaller-scale availability will benefit from the increased presence of health providers and specialists in retail settings. Over the past 12 months, 1,000-plus retail leases were inked by medical-related groups, including urgent care providers, health systems and animal hospitals.

** As of 1Q 2024*
*** Trailing 12 months through 1Q*
**** January through June 9th period*
*Sources: Marcus & Millichap Research Services; Chain Store Age; CoStar Group, Inc.; Placer.ai; PNC Real Estate Market Analytics; Supermarket News; Various company earnings reports and press releases*

## 2024 U.S. Forecast

### EMPLOYMENT

**1.3%** increase Y-O-Y

- Despite a tight labor market, employers grew staffs by 0.8 percent over the first five months of this year. While hiring velocity is expected to gradually slow in the second half, 2 million positions will be added during 2024.

### CONSTRUCTION

**40** million square feet completed

- Delivery volume rises slightly when compared to 2023; however, completions expand inventory by just 0.4 percent for the third time in four years. Of the nation's 50 major markets, 43 record sub-1 percent stock growth.

### VACANCY

**10** basis point increase Y-O-Y

- A fourth straight year of positive net absorption is noted; however, the vacancy rate rises, albeit slightly, for the first time since 2020. Still, at 4.8 percent, vacancy is 100 basis points below the long-term average.

### ASKING RENT

**2.2%** increase Y-O-Y

- A still-limited volume of vacant space in 2024 allows the average asking rent to reach a record mark of $22.88 per square foot. Six of the top 10 metros for marketed rate growth are located in the South.

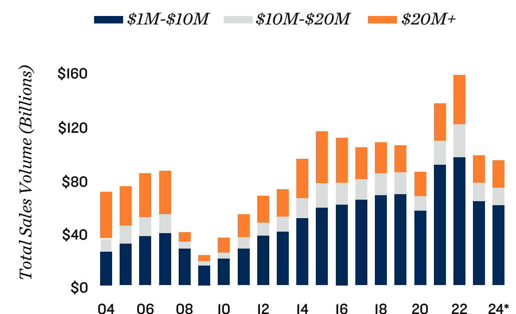
## 2024 INVESTMENT OUTLOOK

- **Tight vacancy and value creation prospects expand strip center appeal.** Typically located closer to consumers than other retail properties and featuring diverse tenants mixes, strip centers are eliciting notable interest from private investors, along with some institutional parties eying portfolio creation. As of April, vacancy in the subsector was at its lowest level since 2003, with sub-$200 per square foot pricing and 7 percent-plus first-year returns common over the past year. Also attracting investors, the potential to capture value by re-tenanting vacant spaces is more frequent than at other retail properties, as leases often carry terms of one to three years.

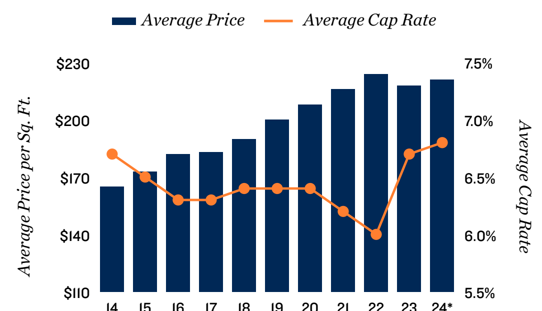
- **Backfilling velocity heightens interest in outdoor centers.** Representing the least vacant multi-tenant property type, at 4.2 percent in March, power centers are also garnering noteworthy attention from active shopping center investors. Competition for these assets stands to escalate, specifically in high growth Sun Belt markets, if recently vacated big box spaces continue to be backfilled in relatively short time frames.

- **New law may shift some buyer attention.** California's eight major markets and its Central Valley accounted for 20 percent of all retail transactions nationally over the past year ending in March. However, a new state law enacted in April requiring fast-food and fast-casual chains with 60 or more locations to pay workers at least $20 per hour could impact investor activity if store closures result. Citing the rising cost of doing business, Rubio's Coastal Grill shuttered 48 California locations in early June.

### Retail Sales Volume By Price Tranche




### Investment Sales Trends




** Trailing 12 months through 1Q*

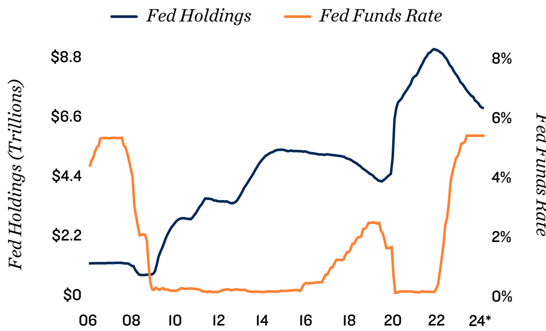
*Sources: Marcus & Millichap Research Services; CoStar Group, Inc.; Real Capital Analytics*

## More Diverse Lending Pool and Potential Late-Year Rate Cuts May Facilitate Transactions

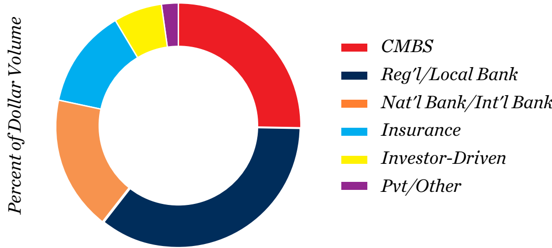
**Reduction still expected in 2024.** The Federal Open Market Committee held the federal funds rate firm at its mid-June meeting, maintaining the lower bound of 5.25 percent first set in July of last year. Moving forward, the Fed's Summary of Economic Projections implies one or two rate cuts could happen this year, with these reductions possibly not occurring until the fourth quarter. This indicates more evidence is needed to confirm inflation is well on its way to the committee's 2 percent year-over-year benchmark. In April, core PCE was up 2.8 percent annually, while core CPI was up 3.4 percent year-over-year in May. How well the labor market and economy hold up will also determine the timing of potential future cuts. Job growth continued to exceed expectations in May, with 272,000 positions added and approximately 1.2 openings per worker available. Resilient consumer spending, meanwhile, supported a 1.3 percent annual increase in GDP in the first quarter of 2024. While the timing of a rate cut remains uncertain, the Fed did implement a new policy in June that will slash its holdings by $25 billion monthly. This will exert less upward pressure on the 10-year Treasury, which combined with a rate cut would translate to modestly lower borrowing costs for commercial real estate investors.

**Financing availability improves.** Last year marked the return of meaningful CMBS lending to the retail investment landscape. These sources accounted for 25 percent of all sector-related financing, following a 12 percent share in 2022. Investors acquiring anchored shopping centers with long-term leases in place were the primary beneficiary, obtaining 55 percent leverage on average. Local and regional banks, meanwhile, accounted for a smaller chunk of lending activity last year, albeit a still notable 35 percent. The main source for single-tenant borrowers seeking sub-$10 million loans, these banks were most active in secondary and tertiary markets, providing investors with 65 percent leverage on average. Looking ahead, the retail sector's tight vacancy and restrained development will continue to rank net-leased assets and well-located shopping centers with high-credit anchors among the more approachable property types for active lenders. For larger investors with significant dry powder and smaller borrowers that have executed 1031 exchanges, however, all-cash transactions will remain an attractive option.

### Monetary Policy Trends




### Retail Mortgage Originations By Lender**




** Federal funds rate as of June 12; Fed holdings as of June 3*
*** 2023; Properties and portfolios $2.5 million and greater*
*Sources: Marcus & Millichap Research Services; Real Capital Analystics; Federal Reserve*

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*Sources: Marcus & Millichap Research Services; Bureau of Economic Analysis; Bureau of Labor Statistics; Chain Store Age; CoStar Group, Inc.; Federal Reserve; Placer.ai; PNC Real Estate Market Analytics; Real Capital Analytics; Supermarket News; U.S. Census Bureau; Various company earnings reports and press releases*

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