NATIONAL REPORT
RETAIL

IPA INSTITUTIONAL PROPERTY ADVISORS

4Q/23

Once-Maligned, Retail Sector is Now Positioned for Potential Headwinds

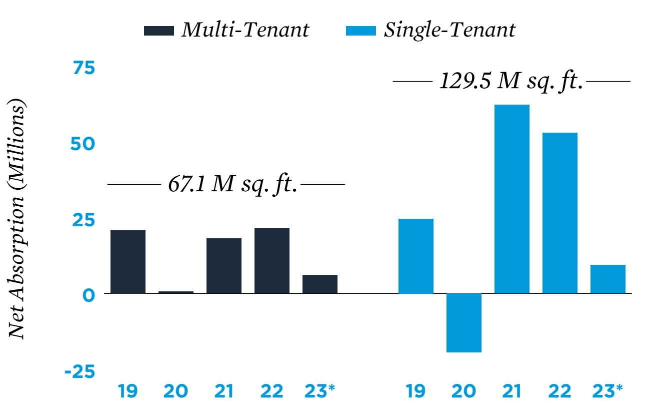
Consumers' resiliency preserves standout performance. As the only commercial real estate segment to record vacancy compression over the 12-month period ending in June, the retail sector remains in a favorable position. A robust labor market that continues to outperform expectations is supporting consumer spending at brick-and-mortar retailers. Before 2022, monthly store-based sales, which exclude purchases made online or at restaurants and bars, had never eclipsed $300 billion. Since September of last year, that threshold has been surpassed eight times. In addition to strong store-based sales, consumers are dining out, with spending at restaurants and bars reaching a record mark in August. These dynamics are supporting positive net absorption, tight vacancy and record asking rents across the property spectrum. Should these trends continue, retailers will likely execute expansion initiatives, bolstering space demand amid a pullback in construction activity.

Holidays test discretionary spending. The recent stretch of store-based spending is encouraging; however, headwinds have emerged that may adversely impact consumers' budgets. As of June, household debt as a percentage of GDP stood at 73.3 percent, exceeding the long-term average. Expectations for record Halloween and holiday spending could raise this figure. Rising credit balances, and the resumption of federal student loan payments, may require consumers to cut back on discretionary spending, including at restaurants, or to rely on discount and off-price retailers for essentials.

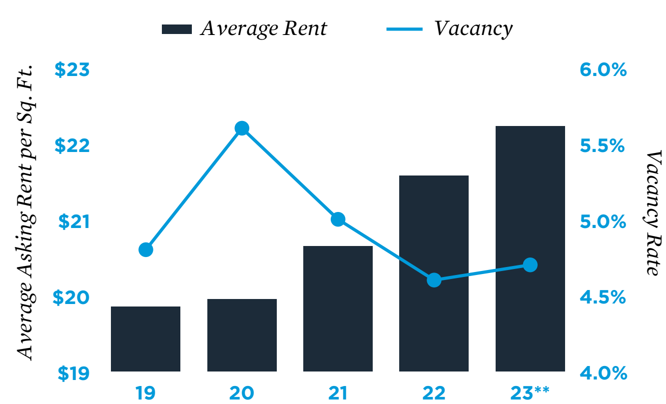
Mergers alter grocer landscape. Two major consolidations are nearing a close that is poised to impact retailer competition and create various scenarios for specific shopping center owners. In September, Kroger and Albertsons announced plans to sell more than 400 stores to C&S Wholesale Grocers to obtain regulatory approval for their merger. Through this acquisition, C&S, whose brands include Piggly Wiggly, would quickly establish a sizable West Coast presence, as more than half of the stores are in California, Oregon or Washington. This news was preceded by Aldi's planned acquisition of Southeastern Grocers in August. Anticipated to close in 2024, this deal will more than triple the discount grocer's current Florida footprint.

Trading reflects private investor sentiment. A combination of tight vacancy, steady rent growth and resilient consumer spending across the sector broadly served to draw investors to listings, despite elevated capital costs. The sector recorded less of a decline in sales activity compared to other major commercial real estate categories, including the multifamily segment, over the 12-month span ending in June. Approximately 94 percent of sales fell between $1 and $10 million, indicating 1031 exchange capital continues to flow into net-leased assets and shopping centers. Tertiary metros accounted for 55 percent of this activity, the largest share of total deal flow since at least 2000. While primary and secondary areas noted drops in transaction share, average pricing across both market types rose modestly. This points to more buyers and sellers coming to an agreement on terms.

Retail Demand Trends



Vacancy and Rent Trends



** 1H 2023*

*** Forecast*

Sources: IPA Research Services; CoStar Group, Inc.; Real Capital Analytics

Net-Leased Spaces and Smaller-Midsize Shopping Centers Exhibit Tight Conditions

Property Type	Inventory*	Vacancy Rate*	Y-O-Y Basis Point Change*	Trailing 12-Month Net Absorption*	Performance Highlights
Comm.-Nbhd. Center	4.2B sq. ft.	5.9%	-40	22.4M sq. ft.	Lowest vacancy since 2005
Regional Mall	1B sq. ft.	9.3%	50	-4.9M sq. ft.	Highest vacancy since 2000
Power Center	1B sq. ft.	4.2%	-20	4.1M sq. ft.	Seven straight quarters of sub-5 percent vacancy
Strip Center	962M sq. ft.	4.3%	-10	3.5M sq. ft.	Lowest vacancy since 2003
Restaurant	699M sq. ft.	3.7%	-20	4.0M sq. ft.	Lowest vacancy since second half of 2018
Supermarket	588M sq. ft.	2.2%	10	4.9M sq. ft.	Vacancy has held below 3 percent since late 2017
Department Store	553M sq. ft.	6.8%	10	507K sq. ft.	Vacancy matches historical high
Fast Food	239M sq. ft.	1.3%	10	1.7M sq. ft.	Vacancy has held below 2 percent since 2012
Lifestyle Center	222M sq. ft.	5.2%	0	993K sq. ft.	Ten straight quarters of positive net absorption
Drug Store	199M sq. ft.	2.3%	30	-343K sq. ft.	Vacancy has held below 3 percent for 18+ years
Convenience Store	171M sq. ft.	1.1%	-20	1.7M sq. ft.	Lowest vacancy since early 2000
Outlet Center	100M sq. ft.	4.9%	0	260K sq. ft.	Vacancy matches prior 10-year average

** As of 3Q 2023*

Sources: IPA Research Services; CoStar Group, Inc.

Candidates in Place to Backfill Vacated Spaces

Mid-sized buildings secure national tenants. Following a recent wave of closures that included all Bed Bath & Beyond, Tuesday Morning and Buy-Buy Baby locations, another collection of stores will shutter in the next 18 months — including more than 100 underperforming Champs Sports. Fortunately for property owners impacted by upcoming closures, expanding retailers face limited options. Vacancy is low by historical standards across most retail property types, and the volume of space underway as of October equated to just 0.6 percent of existing stock. Together, these factors increase the likelihood that recently-vacated spaces could secure new tenants in a relatively short time frame. During the first three quarters of 2023, home goods retailers, including Floor & Décor, off-price apparel companies and hobby stores were primarily responsible for backfilling 30,000- to 50,000-square-foot buildings. Launching its small-store format, Macy's stands to play a role in this space moving forward, as does Nordstrom Rack.

Sector-specific exodus opens the door for discount and experiential growth. Owners of net-leased drug stores or shopping centers with pharmacy anchors also face closures that may impact their bottom line. Rite Aid, Walgreens and CVS collectively plan to close at least 850 stores by the end of 2024, most of which are 10,000 to 20,000 square feet in scope. This dynamic may end an extended stretch of sub-3 percent vacancy in the drug store sector; however, it also presents opportunities for retailers, specifically discount stores, to grow their reach. Dollar Tree and Dollar General have already backfilled drug stores this year, with Family Dollar and Five Below candidates to occupy similar buildings moving forward. Making its brick-and-mortar comeback, Toys "R" Us, along with expanding Ace Hardware, gyms and other experiential retailers should also vie for these spaces.

Maturation of "medtail" to potentially boost foot traffic at centers. Intent on bringing care closer to consumers, health providers and specialists are growing their presence in retail settings. Through the first nine months of 2023, upward of 1,000 retail leases were inked nationally by medical-related groups, many for spaces under 5,000 square feet in shopping centers. This total included a collection of animal hospitals, a trend that should continue as nearly 87 million U.S. households own a pet. The impact of medtail may also carry over into larger spaces. Novant Health recently acquired a former Sears in Winston-Salem, and HCA Healthcare opened a 48,000-square-foot facility at a suburban Houston lifestyle center.

2023 Forecast

EMPLOYMENT

1.9% increase Y-O-Y

- By the end of 2023, total employment is expected to extend nearly 5.7 million jobs above the year-end 2019 mark. Despite unemployment entering the year at a multi-decade low, 2.9 million positions will be added.

CONSTRUCTION

42 million square feet completed

- Delivery volume is anticipated to reach a three-year high. Second half supply additions will exceed the previous six-month tally of 15.3 million square feet, supporting inventory growth of 0.5 percent in 2023.

VACANCY

10 basis point increase Y-O-Y

- After holding at a historically tight rate during the first half, vacancy rises slightly over the final six months of 2023. This places year-end vacancy at 4.7 percent, a rate 120 basis points below the long-term average.

ASKING RENT

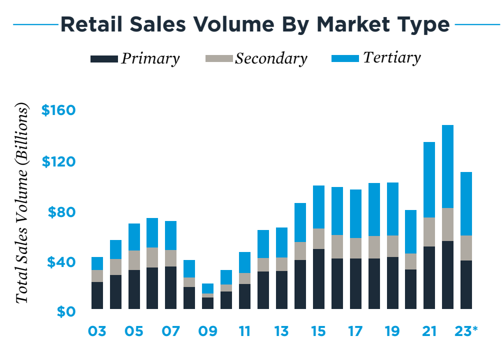
3.0% increase Y-O-Y

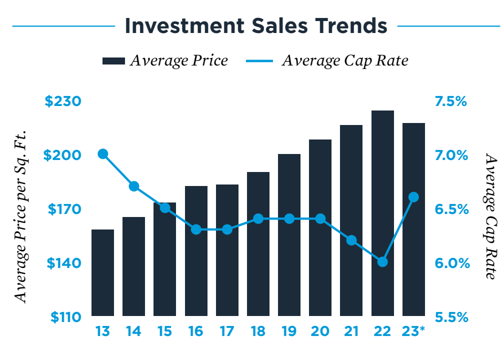
- Positive net absorption and tight conditions across net-leased categories translate to an 11th straight year of rent growth. By year-end, the mean asking rate will sit at a record mark of $22.23 per square foot.

2023 INVESTMENT OUTLOOK

- **Budget-friendly dining trends aid net-leased trading velocity.** Spending at restaurants and bars rose 8.5 percent over the past year ending in August, the largest gain among retail categories. Patronage at fast casual and quick service chains held the greatest share, as consumers' reliance on lower-cost dining options has risen as their budgets have tightened. Across restaurant categories, Starbucks, Chipotle, Burger King, Jack in the Box and Chick-fil-A each ranked among the top performers in terms of year-over-year sales growth through August. These gains are poised to fuel investor competition for assets net-leased to these tenants, along with vacant properties with drive-thrus. Recent pricing trends reflect buyers' confidence in the quick service segment. Over the first nine months of 2023, fast-food properties sold 1.4 percent above their asking price on average, a contrast to other retail segments.

- **Population gains underscore opportunities.** One of eight retail assets that sold over the past year ending in June was either in a major Texas or Mountain West metro. Across these eight markets, growth projections have and should continue to fuel buyer activity, as each metro's populace is expected to expand by 5 percent to 10 percent during the 2023-2027 interval. Specifically, Phoenix may appeal to more investors. The metro noted the largest year-over-year vacancy compression, 120 basis points, among major U.S. markets in the second quarter, and will add 400,000 residents over the next five years. These dynamics and an average asking rent nearly $3 per square foot below the national mean should provide buyers with upside potential.

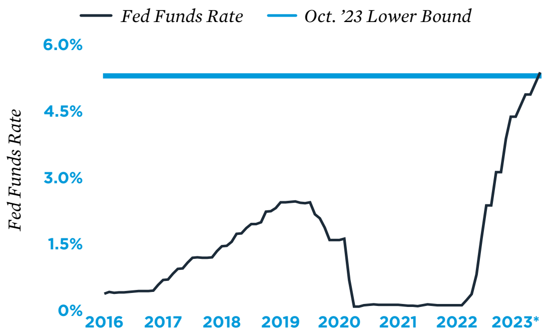




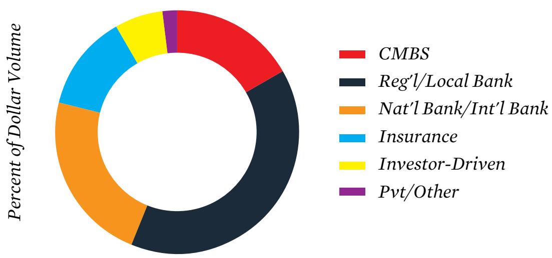
* Trailing 12 months through 2Q

Sources: IPA Research Services; CoStar Group, Inc.; Real Capital Analytics

Federal Funds Rate Over Time



Retail Mortgage Originations By Lender**



* As of October 4

** 1H 2023; Properties and portfolios $2.5 million and greater

Sources: IPA Research Services; Real Capital Analytics; Federal Reserve

Rate Stability and a More Diverse Composition of Lenders Assist the Deal-making Process

Extension of rate hike hiatus a possibility. The Federal Open Market Committee held the federal funds rate firm at its late September meeting, maintaining the lower bound of 5.25 percent first set in July. Moving forward, Wall Street estimates the chance of a hold through year-end at over 60 percent, with many economists suggesting the Fed is likely done hiking rates in 2023. Backing these projections, long-term U.S. Treasury yields have reached their highest point in more than 15 years, and the rate of core PCE inflation has slowed. Still, a persistently tight labor market could give the Federal Reserve ammunition to consider interest rate raises at its upcoming meetings, specifically if the strong momentum recorded in September continues. If a prolonged hiatus does come to fruition, however, it would support a more stable interest rate environment. The potential peak of the current hike cycle would aid retail transaction velocity, following an 18-month span of a rapid upward adjustment that complicated the acquisition process and pushed some investors to the sidelines.

Lenders' appetite for retail remains intact or improves. Net-leased assets and well-located shopping centers with national anchors and long-term leases in place remain extremely approachable properties for lenders, some of which are engaging in the marketplace with greater regularity. During the first half of 2023, CMBS, life insurance companies and national banks collectively accounted for nearly half of all retail lending, compared to a 38 percent share in 2022. These sources are focusing the bulk of their attention on anchored and unanchored shopping centers, providing loans averaging from $11 million to over $15 million. CMBS lenders are exhibiting a preference for assets in Southwest and West Coast metros of late, with financing availability in the 50 percent LTV range. Life companies, meanwhile, have been active in Northeast markets, financing deals at a slightly higher leverage than conduits. For single-tenant borrowers, local and regional banks remain the primary financing resource, accounting for 60 percent of all lending in the subsector during the first six months of 2023. Providing loans at an average LTV of 65 percent, these lenders also represent the main supplier of capital for tertiary-located, multi-tenant deals. Moving forward, tight vacancy, a restrained development pipeline and record asking rents should support a more diverse lending platform. Still, some distress could arise as higher-leverage loans obtained over the past five years come due during a period of higher capital costs and lower LTVs.

Office Division

Daniel Taub

Senior Vice President, Director

Tel: (212) 430-5100 | daniel.taub@marcusmillichap.com

Prepared and edited by:

Erik Pisor

Research Analyst | Research Services

For information on national office trends, contact:

John Chang

Senior Vice President, Director | Research & Advisory Services

Tel: (602) 707-9700 | jchang@ipausa.com

Price: $1,500

Sources: IPA Research Services; CoStar Group, Inc.; Real Capital Analytics; Bureau of Labor Statistics; Federal Reserve; Coresight Research; Prodege