NATIONAL REPORT

Marcus & Millichap

SINGLE-TENANT NET-LEASE RETAIL

2H/23

Already on Solid Footing, Single-Tenant Demand Poised to Exceed Near-Term Supply

Outlook aided by consumers' focus on personal care and dining. Exhibiting historically low vacancy and a record asking rent in June, the single-tenant sector exemplifies the overall strength of the nation's retail segment. A robust labor market that continues to outperform expectations is supporting consumer spending at brick-and-mortar stores and restaurants. Before 2023, monthly core retail sales, which exclude gas and auto purchases, had never exceeded $500 billion. Since January of this year, that threshold has been surpassed seven times. This achievement reflects consumers' prioritization of necessities and dining out during the first nine months of 2023. Over this interval, spending at health and personal care stores, and restaurants and bars, rose 7.9 and 11.9 percent, respectively, on a year-over-year basis. Should these trends continue amid a pullback in construction, a multi-year span of positive net absorption should extend.

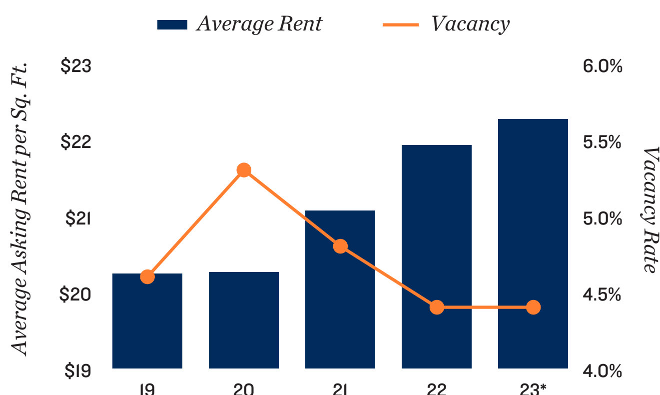
Metro-level fundamentals reflect broad demand for space. Among the nation's 51 major retail markets, 29 entered the second half of 2023 with a single-tenant vacancy rate below their year-end 2019 mark. This group included eight Sun Belt markets where retail vacancy was at least 100 basis points below the area's immediate pre-pandemic recording — a list highlighted by Phoenix, Las Vegas, Austin and Tampa. This broad demand for net-leased space has the sector equipped to handle headwinds, such as rising credit balances and federal student loan payments, that may adversely impact more consumers' budgets.

Single-Tenant Investment Highlights

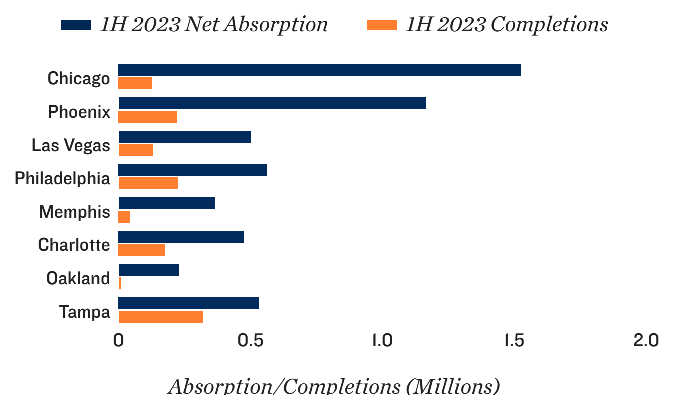
Net-leased assets coveted, despite elevated capital costs. Single-tenant trades accounted for nearly one-fourth of all primary commercial real estate deal flow during the 12-month period ending in June. The segment's share of total trading exceeded its prior yearlong proportion, when 21 percent of all sales involved a single-tenant asset. Further reflecting investors' confidence in the long-term performance of the subsector, the single-tenant transaction count for the first six months of 2023 was the fifth-highest first half tally since 2000. For borrowers, local and regional banks were the primary financing resource during this interval, accounting for 60 percent of all lending. Moving forward, the potential peak of the Federal Reserve's current hiking cycle would support a more diverse lending platform and aid transaction velocity, after an 18-month span of a rapid upward adjustment pushed some investors to the sidelines.

Smaller markets provide upside. At 3.7 percent in June, tertiary single-tenant vacancy is extremely tight, with the average asking rent across this category up a collective 19 percent since year-end 2019. These standout fundamentals are attracting more investors to net-leased opportunities in smaller markets. Specifically, over the yearlong period ending in the second quarter, tertiary transactions represented nearly 60 percent of all single-tenant trading, the highest share on record. Recent sales activity was highlighted by year-over-year improvements in Indianapolis, Richmond and Tulsa, with deal flow unchanged in Louisville, California's Central Valley and a group of southern cities.

Vacancy and Rent Trends



First Half Supply vs. Demand Standouts



** As of 2Q*

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

Most Net-Leased Spaces Register Historically Tight Conditions

Property Type	Inventory*	Vacancy Rate*	Y-O-Y Basis Point Change*	Trailing 12-Month Net Absorption*	Performance Highlights
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
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

** As of 3Q*

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

Restaurant and Health-Related Spending Trends Support Expansion Plans

Investors exhibit confidence in restaurant segment. A recent sampling of national chains revealed that most casual dining, fast casual and quick service restaurants grew their store count during the first three quarters of 2023, led by YUM! Brands, McDonald's, Chipotle and Wingstop. A rise in consumers' reliance on lower-cost dining options amid budget tightening should further fast casual and quick service brands' expansion initiatives — a list that includes Dutch Bros and other drive-thru coffee chains. This has the potential to preserve extremely tight conditions in the subsector. Recent sales activity suggests investors are confident in this outcome, with fast-food properties transacted through September of this year trading 1.4 percent above their asking price on average, a contrast to other retail segments. A certain cohort of investors also appear confident in their ability to either re-tenant or redevelop restaurant space, as numerous vacant, casual dining buildings traded in the first three quarters of this year for less than $3 million.

Specific closures open the door for discount and experiential growth. Nationwide, a collection of drug stores will shutter in the coming quarters, potentially ending an extended stretch of sub-3 percent vacancy in the subsector. Specifically, Rite Aid, Walgreens and CVS collectively plan to exit at least 850 stores by the end of 2024, most of which are 10,000 to 20,000 square feet in scope. While daunting on the surface, these closures will create opportunities for other expanding retailers, specifically discount stores, gyms and pickleball companies, some of which have already backfilled drug stores this year. Grocers and superstores branching out or expanding their pharmacy-related reach may also vie for these buildings, motivated by consumers' record level of health and personal care spending.

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Sources: Marcus & Millichap Research Services; U.S. Census Bureau; CoStar Group, Inc.; RetailStat Financial