NATIONAL REPORT

Marcus & Millichap

RETAIL

4Q/24

Sector's Strength Coincides With Monetary Policy Shift That Could Prove Vital to Consumer Spending, Investment Activity and Retailer Demand

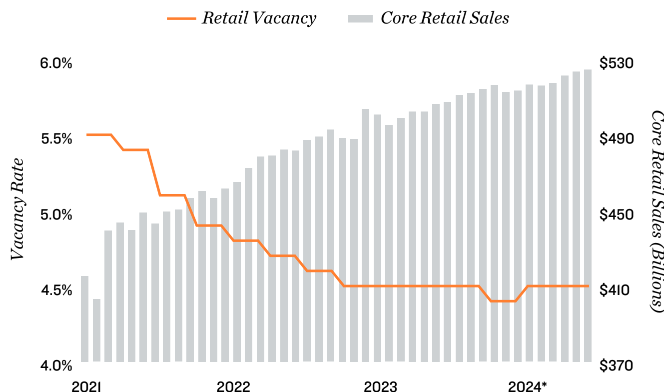
Potential headwinds could be negated. The retail sector entered the second half of 2024 as the only major commercial real estate property type with a vacancy rate below its year-end 2019 recording. Consumer resiliency empowered standout tenant demand across the segment. Core retail sales reached a record mark in August, with spending up in real terms even after factoring in core CPI inflation. While household budget tightening and labor market softness remain potential headwinds that could impact the sector, the Federal Open Market Committee's overnight lending rate cut in September likely launched a lowering cycle that will extend through next year and possibly offset the impacts of these factors. As these reductions take place, downward pressure on mortgage rates, auto loans and credit card fees will be applied. This will give households an opportunity to save an impactful amount of money, potentially aiding discretionary spending, retail foot traffic and ultimately tenant demand for space.

Broad demand exists for space. National vacancy has held below 5 percent for 11-straight quarters, with the average asking rent rising throughout. The sector's strength extends across market types, with primary and secondary vacancy at 4.7 and 4.5 percent, respectively, in June and the tertiary rate at 3.9 percent. This widespread demand warrants construction; however, as of October, the active pipeline equated to just 0.4 percent of existing stock, with three-fourths of this space accounted for. The limited volume of available square footage underway should steer most expanding retailers to existing stock.

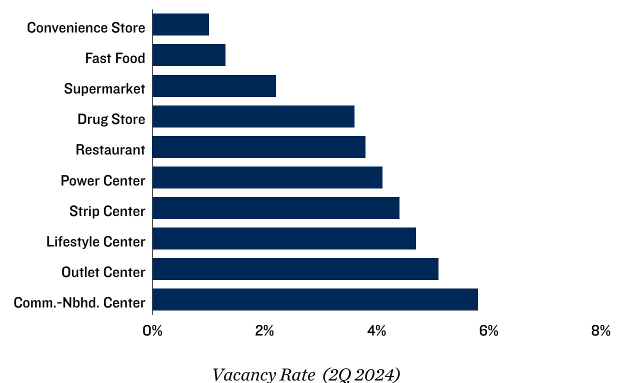
Potential consolidations have ramifications for property owners. A trio of proposed mergers are poised to shift the landscape of certain retail property segments should they be authorized. At the onset of October, two hearing decisions regarding the Kroger-Albertsons merger were pending — one in Washington state and another brought by the Federal Trade Commission, with an additional third review case having started in Colorado on September 30. Meanwhile, a FTC hearing focused on Tempur Sealy's merger with Mattress Firm, which would create a nearly 3,000-store global entity, will begin on November 12. Saks Fifth Avenue's acquisition of Neiman Marcus appears further along as the waiting period under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 expired in late August.

Private buyer pool remains sizable. Among the nation's main commercial real estate segments, the retail sector accounted for more than 40 percent of trades in the $1 million to $10 million price tranche over the past year ended in June. This share of deal flow indicates a cohort of private investors, despite financing hurdles, are focused on net-leased assets and smaller shopping centers, often as part of 1031 exchange transactions. These buyers have been more active as of late. Preliminary data from the first half reveals the number of $1 million to $10 million closings recorded from April through June rose 10 percent on a quarterly basis. Moving forward, lower borrowing costs and favorable sector dynamics should heighten investor competition for these listings, especially if consumer spending remains resilient.

Record Spending Supports Strong Tenant Demand



Limited Vacancy Apparent Across Property Types



** Vacancy as of 2Q, Core retail sales through August*

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

Vacancy at or Near a Record Low in More Than Half of the Nation's Major Markets

Mountain

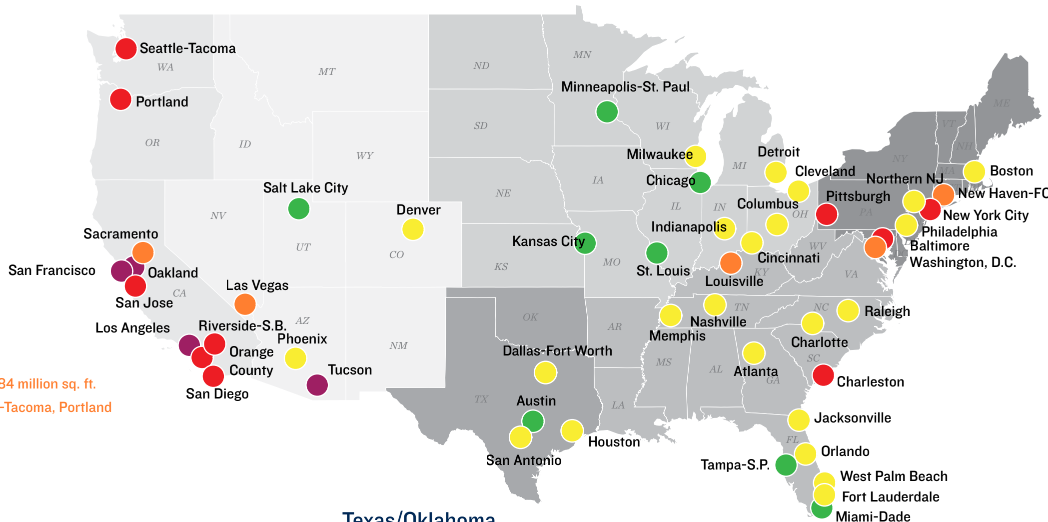
Regional Vacancy 4.9%
2Q 2024
12-Month Net Absorption 1.52 million sq. ft.
Least Vacant Metros: Salt Lake City, Denver

Midwest

Regional Vacancy 4.6%
2Q 2024
12-Month Net Absorption 9.56 million sq. ft.
Least Vacant Metros: Minneapolis-St. Paul, Indianapolis

Northeast

Regional Vacancy 4.2%
2Q 2024
12-Month Net Absorption 4.46 million sq. ft.
Least Vacant Metros: Northern New Jersey, Boston



West

Regional Vacancy 5.7%
2Q 2024
12-Month Net Absorption -2.84 million sq. ft.
Least Vacant Metros: Seattle-Tacoma, Portland

Texas/Oklahoma

Regional Vacancy 4.8%
2Q 2024
12-Month Net Absorption 7.58 million sq. ft.
Least Vacant Metros: Austin, San Antonio

South

Regional Vacancy 3.5%
2Q 2024
12-Month Net Absorption 9.31 million sq. ft.
Least Vacant Metros: Raleigh, Miami-Dade

2Q 2024 Vacancy

- *Record Low*
- *10 to 50 bps above record low*
- *60 to 100 bps above record low*
- *110 to 200 bps above record low*
- *200+ bps above record low*

REGIONAL STANDOUTS	PERFORMANCE HIGHLIGHTS
Austin	*Vacancy 210 basis points below long-term mean*
Boston	*Least vacant primary market (2.9 percent)*
Denver	*Vacancy 130 basis points below long-term mean*
Indianapolis	*Vacancy in the 3 percent range since 1Q 2022*
Miami-Dade	*Sub-3 percent vacancy; 14 percent asking rent growth over the past year*
Minneapolis-St. Paul	*Led all major markets in vacancy compression over the past 12 months (80 basis points)*
Northern New Jersey	*Sub-3 percent vacancy since 1Q 2022*
Portland	*Sub-4 percent vacancy in half of its submarkets*
Raleigh	*Least vacant major U.S. market (2.3 percent)*
Salt Lake City	*Lowest vacancy among major Mountain and West Coast markets (3.2 percent)*
San Antonio	*Vacancy below 4 percent in 10 of 12 submarkets*
Seattle-Tacoma	*Sub-4 percent vacancy since 2Q 2016*

U.S. Metric Skewed by California Markets

Robust demand prevalent across most metros. National retail vacancy is at a historically low level; yet, when removing California performance data from the equation, conditions are even tighter. Vacancy across the 42 major markets located outside the state collectively dipped 10 basis points to 4.3 percent over the 12-month stretch ended in June, with tenants absorbing a net of 32 million square feet. Of these metros, 37 registered average asking rent growth, with 10 — primarily a mix of Midwest and South markets — noting reductions in both single- and multi-tenant vacancy. These dynamics are poised to benefit property owners in these metros and elicit additional investor interest amid a broad pullback in construction. In contrast, collective vacancy in California's eight major markets rose 30 basis points over the past year to 5.9 percent, with three of eight noting declines in average marketed rent. Among this group, only the Inland Empire entered July with a vacancy rate below its year-end 2019 recording.

Sources: Marcus & Millichap Research Services

2024 Forecast

EMPLOYMENT

1.3% increase Y-O-Y

- Although hiring velocity slowed in June and July, employers still grew staffs by 0.9 percent over the first eight months of this year. This has the nation's workforce on pace to expand by 2 million positions in 2024.

CONSTRUCTION

40 million square feet completed

- Delivery volume rises slightly on an annual basis; however, many major markets note inventory growth below 0.5 percent. Dallas-Fort Worth, Houston, Phoenix and Austin account for nearly 30 percent of 2024 additions.

VACANCY

20 basis point increase Y-O-Y

- After reaching an all-time low last year, vacancy rises to 4.6 percent as supply outpaces demand for the first time since 2020. This rate is nevertheless 110 basis points below the nation's long-term average.

ASKING RENT

2.2% increase Y-O-Y

- Positive absorption equates to a still-limited volume of vacant space. This allows the mean asking rent to reach a record of $22.90 per square foot, with above-average gains expected across most Sun Belt markets.

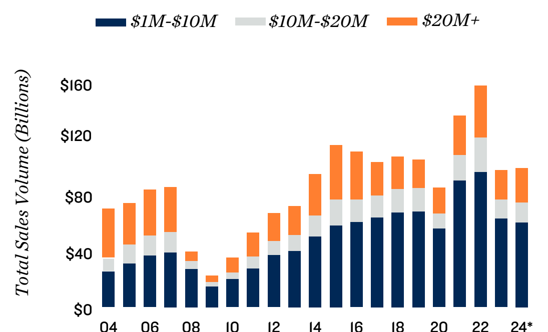
2024 INVESTMENT OUTLOOK

- **Subsector activity contrasts broader trend.** Retail deal flow fell on an annual basis over the first eight months of 2024; yet, the number of fast food-related trades rose. The segment's scant vacancy and number of chains in expansion mode is eliciting investor competition for properties net-leased to these tenants. Notable brands charting growth include Freddy's Frozen Custard and Steakburgers, Bojangles, and Raising Canes, with a sizable group of lesser-known chains expanding regionally — a list that features District Taco, Nick the Greek and Smalls Sliders. Should spending at restaurants continue to reach new heights, private investor demand for assets occupied by or well-suited for fast-food operations could heat up.

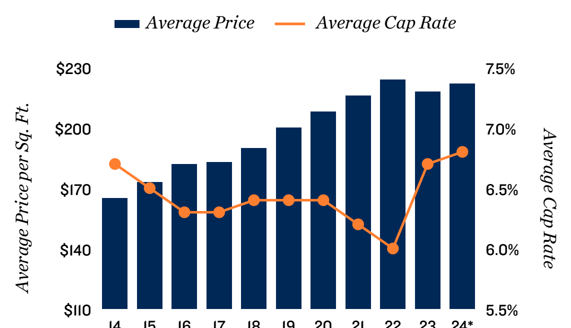
- **Backfilling timelines heighten interest in centers.** Larger spaces vacated by the likes of Bed Bath & Beyond, BuyBuy Baby and recently 99 Cents Only are being backfilled in relatively short time frames, often by discount and off-price retailers. Amid a period of limited construction and tight conditions, power and neighborhood centers with big-box moveouts on the horizon may prove appealing to upside-seeking investors confident in their ability to re-tenant spaces at higher rents.

- **Tightest single-tenant segment garners attention.** Foot traffic at convenience stores outpaced or held steady compared with 2023 in seven out of the first eight months of 2024, indicating consumers are prioritizing affordable quick-stop options. This dynamic is pushing Wawa, Buc-ee's and Sheetz to new areas, while also attracting buyers to standalone convenience stores and smaller centers with these tenants.

Retail Sales Volume By Price Tranche



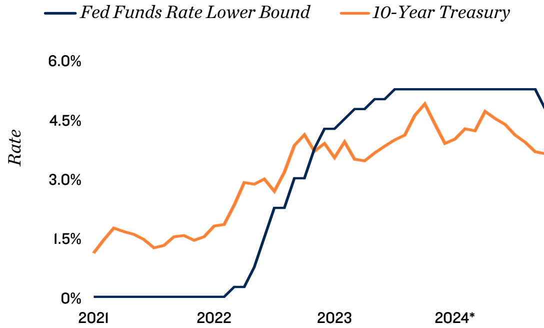
Investment Sales Trends



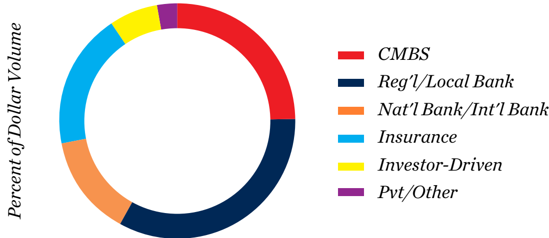
* Trailing 12 months through 2Q

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

Rate Movement Bodes Well for Borrowing Costs



Retail Mortgage Originations By Lender**



Federal funds rate and treasury yield as of Sept. 18

*** 1H 2024; Properties and portfolios $2.5 million and greater*

Sources: Marcus & Millichap Research Services; Real Capital Analytics; Federal Reserve

Rate Cuts and Relatively Higher Leverage Have Positive Implications for Investment Activity

Long-awaited lowering kicks off greater reduction cycle. The Federal Open Market Committee (FOMC) slashed the federal funds rate by 50 basis points in September, setting the lower bound at 4.75 percent. The first cut since March 2020, this decision reflects the Fed's confidence that inflation is moving toward 2 percent and its intent to prevent further labor market softness. In August, core PCE was up 2.7 percent annually, with unemployment sitting at 4.2 percent. With two meetings remaining in 2024, the Fed is expected to lower interest rates again by year-end. Further reduction to the overnight lending rate and less upward pressure on the 10-Year Treasury — which has fallen under the 4 percent threshold it exceeded for much of the year — will contribute to modestly lower borrowing costs. This dynamic may help re-open the yield spread relative to cap rates. As such, additional transaction activity could materialize in the retail sector, as elevated levels of dry powder capital await deployment and the segment's stretch of historically low vacancy elicits buyer interest.

Retail remains one of the more approachable property types. The recently announced interest rate cut and expectations for further reductions are likely to heighten investor demand for financing and credit availability, translating to a rise in loan originations. For retailer borrowers, a more diverse lender base is positioned to offer higher leverage loans. This trend emerged prior to the September rate cut, partially facilitated by pricing for retail assets rising slightly over the 12-month period ended in June. Specifically, during the first half of 2024, the average loan-to-value (LTV) provided by CMBS lenders increased 430 basis points to 56.6 percent compared with the same period in 2023. Concurrently, mean leverage offered by life insurance companies rose 150 basis points to 60.1 percent, with the source also increasing its share of overall retail lending — 19 percent —during the first six months of 2024. Borrowers seeking financing for anchored and unanchored shopping centers were most impacted by these changes. Meanwhile, single-tenant borrowers continued to lean on regional and local banks, who accounted for nearly half of all lending in the segment during the first half. Leverage offered by these sources, typically for sub-$10 million properties, remained relatively steady over the recent six-month stretch, averaging just above 63 percent.

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Sources: Marcus & Millichap Research Services; CoStar Group, Inc.; Federal Reserve; Federal Trade Commission; MSCI; Placer.ai; PNC Real Estate Market Analytics; Real Capital Analytics; U.S. Bureau of Labor Statistics; Various company press releases