NATIONAL REPORT

Marcus & Millichap

RETAIL

3Q/25

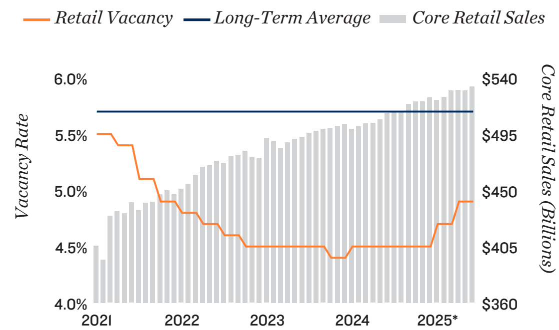
New Tariffs and Shifting Tenant Demand Test Commercial Real Estate's Least-Vacant Sector

Retail segment enters unfamiliar territory. After an impressive four-year stretch of tenant demand, both the single- and multi-tenant retail sectors saw more space relinquished than absorbed in the first half of 2025, translating to negative net absorption of nearly 15 million square feet. This shift is significant; consecutive quarters of negative absorption have not occurred at any other point this century, except for during the height of the pandemic. Moving forward, tenant demand for space will be tested. Signs of a pullback in consumer spending have begun to materialize following months of expectations-exceeding resiliency. In July, core retail sales dipped slightly on a monthly basis after accounting for inflation. The largest declines were registered across discretionary categories — an indication consumers are beginning to prioritize necessities ahead of potential budget tightening. This behavior, coupled with declining overall sentiment, a recent drawback in hiring and a slower expected rate of economic growth, point to the possibility of a volatile second half for some retailers and property owners.

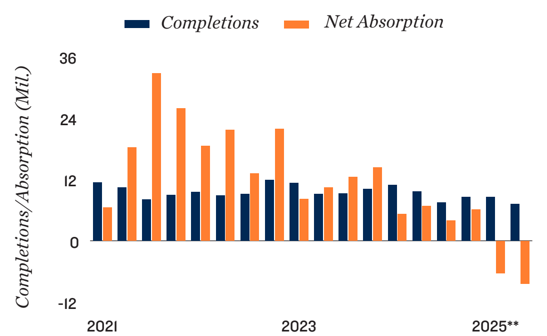
Impact of new tariffs yet to be fully realized. Some retail categories displayed tariff-related price increases during the second quarter; however, relatively soft goods inflation during the period suggests many firms delayed passing costs onto consumers. This may change during the second half, as companies are more likely to transfer higher costs to consumers once inventories turn over. A group of retailers including department, apparel, sporting goods, electronics, home goods and auto repair stores will each be moderately to highly exposed to tariffs in the coming quarters. If consumers pull away from these categories as more tariff pressures mount, additional strain could be placed on retailers in these price-sensitive segments. Fortunately, property fundamentals remained historically strong at the onset of the second half, with a favorable supply-demand balance in place.

Pullback in construction may aid existing properties during volatile period. Retail vacancy rose 40 basis points during the first half; however, at 4.9 percent, the sector's rate is on par with its prior 10-year average and 80 basis points below the long-term mean. Vacancy levels are low enough to keep the average asking rent at a record mark. Meanwhile, a construction slowdown is materializing. Specifically, developers added just 7.2 million square feet in the second quarter — the lowest total for a three-month period since at least 2000. Minimal supply-side pressure is expected over the near term, with the active pipeline as of August equating to just 0.7 percent of existing inventory. Three-fourths of this space was accounted for as of August, steering many expansion-minded retailers to existing properties through at least 2026. This may be most apparent in California, Midwest and Northeast markets. Most major metros in these regions are slated to record inventory growth below the national rate of increase — 0.4 percent — this year.

Tenant Demand Remains Historically Strong



First Half Marked by Shift in Net Absorption



Stores Face Various Exposure to Tariffs

* 2Q Vacancy; Core retail sales through July

** Through 2Q 2025

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

Single- and Multi-Tenant Sectors Characterized by Fragmented Property Performance

Single-Tenant Net-Lease Fundamentals

Construction — 0.4% — *Active pipeline as a percentage of existing inventory*

Vacancy — 4.6% — *Vacancy has hovered in the 4 percent range for four straight years*

Rent — $22.96 — *Average per square foot asking rent for single-tenant space — a record mark*

Multi-Tenant Fundamentals

Construction — 0.7% — *Active pipeline as a percentage of existing inventory*

Vacancy — 5.9% — *2Q vacancy 10 basis points below sector's prior 10-year mean*

Rent — $21.84 — *Average per square foot asking rent for multi-tenant space — a record mark*

SINGLE-TENANT TRENDS

- While drug and department store vacancy rates have risen to historically high marks, available space remains scant among other single-tenant net-lease categories. The convenience store, fast food and auto repair sectors each entered July with sub-2 percent vacancy; supermarket availability was at 2.3 percent.
- The restaurant sector was the only single-tenant category to note a vacancy decline over the past year. Positive leasing is being supported by consumer spending, with restaurant and bar sales up 5.6 percent year over year in July.
- Developers completed 5.1 million square feet of single-tenant space in the second quarter of 2025 — the lowest three-month total since at least 2007. Should a broader pullback in supply additions materialize, tenant competition for existing spaces could improve.

MULTI-TENANT TRENDS

- All multi-tenant segments noted negative net absorption in the first half, pushing sector vacancy up to 5.9 percent. This rate, however, is skewed by regional mall vacancy, which entered July at a record high of 10.5 percent. When removing the property type, multi-tenant vacancy is in the low-5 percent band.
- Strip and power centers continue to outperform the broader multi-tenant sector. At the onset of the second half, vacancy across both property types was 4.6 percent, with each segments' rate having held below 5 percent since late 2021.
- The sector is also noting a pullback in deliveries. Over the past year, half of the nation's 50 major retail markets noted multi-tenant inventory growth of less than 0.2 percent, which should aid property owners attempting to backfill space.

Wave of Store Closures Distract From Encouraging Backfilling Activity

Top Tenants - Second-Half Move-Ins

(1K-20K SQ. FT.)	(20K+ SQ. FT.)
Dollar General (*335K sq. ft.*)	Crunch Fitness (*1.6 M sq. ft.*)
Dollar Tree (*267K sq. ft.*)	Target (*699K sq. ft.*)
Five Below (*130K sq. ft.*)	Walmart (*625K sq. ft.*)
Spencer Gifts (*113K sq. ft.*)	Sky Zone (*447K sq. ft.*)
Ace Hardware (*110K sq. ft.*)	The Picklr (*437K sq. ft.*)
Chipotle (*99K sq. ft.*)	Fun City (*376K sq. ft.*)
Grocery Outlet (*96K sq. ft.*)	Costco (*371K sq. ft.*)
Boot Barn (*88K sq. ft.*)	Aldi (*360K sq. ft.*)
Chick-Fil-A (*87K sq. ft.*)	H-E-B (*322K sq. ft.*)
Wawa (*59K sq. ft.*)	Round One (*319K sq. ft.*)
Starbucks (*53K sq. ft.*)	Kroger (*315K sq. ft.*)

Favorable time-on-the-market trend emerges. The number of store closures outpaced openings by an estimated 2,000 locations in the first half of 2025 after a net loss of 1,350 stores was noted during the prior year. Concurrently, however, the mean time on the market for vacant space improved, a boon for property owners grappling with recent or upcoming move-outs. Specifically, spaces that secured new leases were on the market for an average of nine months, down from the prior four-year mean of 11 months. If backfilling timelines remain below average, the wave of second-half closures may have less of an impact on overall fundamentals.

Experiential retailers filling big-box space. Consumer demand for exercise and family entertainment options is evident, as tenants that operate in these categories are expanding. Since 2024, Crunch Fitness, Sky Zone, The Picklr and Fun City Adventure Park have combined to ink more than 200 new leases nationwide for spaces larger than 20,000 square feet. Most of these leases carry terms of 10 years, providing stability to the shopping centers these tenants occupy.

Note: Move-ins slated to occur after June 2025 based on in-place lease commitments as of August

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

2025 Forecast

EMPLOYMENT

0.6% increase Y-O-Y

- Job growth cooled during the May-July period with the national headcount growing by just 106,000 roles. A subdued pace of hiring is expected moving forward, impacting the number of positions added in 2025.

CONSTRUCTION

34 million square feet

- The volume of retail space delivered this year ranks as the smallest tally this century. Completions in Dallas-Fort Worth, Houston, Phoenix and Austin collectively compose one-third of 2025's supply additions.

VACANCY

50 basis point increase Y-O-Y

- After rising by 40 basis points during the first half, the pace of vacancy increase is expected to moderate in the second half. Still, the national rate reaches 5.0 percent — the highest year-end mark since 2015.

EFFECTIVE RENT

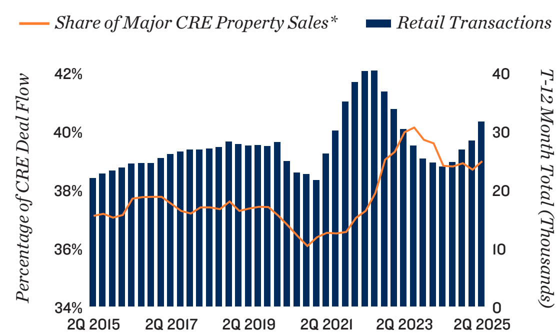
1.0% increase Y-O-Y

- While moderate, the increase to average asking rent registered in 2025 is enough to lift the metric to a record mark of $22.73 per square foot. More than two-thirds of major metros note upward movement.

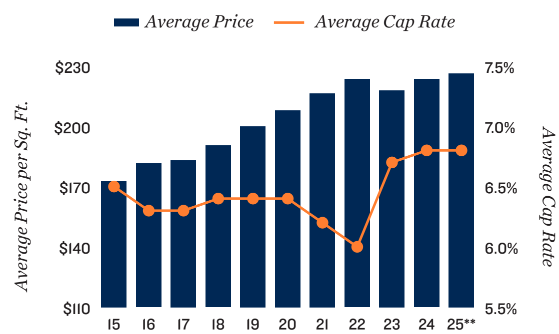
2025 INVESTMENT OUTLOOK

- **Recent trading velocity exceeds prior 10-year mean.** Consumers' resilience, favorable fundamentals across most property types and greater pricing certainty have lifted buyer competition for retail assets. Specifically, the number of closings recorded in 2025 from April to June ranked as the highest quarterly total in three years. Trades in the $1 million to $5 million band accounted for 85 percent of all deal flow, reflecting the count of net-leased assets and smaller shopping centers that changed hands. These properties, specifically assets net-leased to fast food, convenience store and auto repair tenants, will continue to elicit attention from investors seeking less management-intensive ownership in segments with scant vacancy. Strip centers will also garner attention, as they fit the needs of a diverse tenant base and face minimal supply-side pressure.
- **Elevated cap rates entice certain buyers.** Assets that changed hands over the past year ended in June netted investors an average first-year return of 6.8 percent — the highest mean since 2013. Moving forward, buyers with an appetite for 7 percent-plus yields that have experience re-tenanting assets may target community and neighborhood centers with upcoming move-outs or recently vacated former drug stores in markets noting encouraging backfilling activity.
- **Regional strength catalyzes investment.** Every major metro in the South entered July with a single-tenant vacancy rate below the national average. This dynamic is likely to attract investors to net-leased assets in top-performing markets, which include Raleigh, Charlotte, Charleston, Louisville and Nashville.

Retail a Favored Sector Among Investors

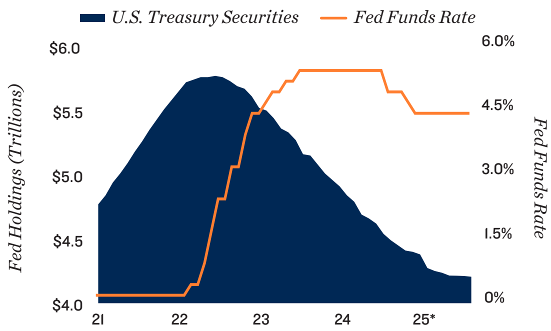


Investment Sales Trends

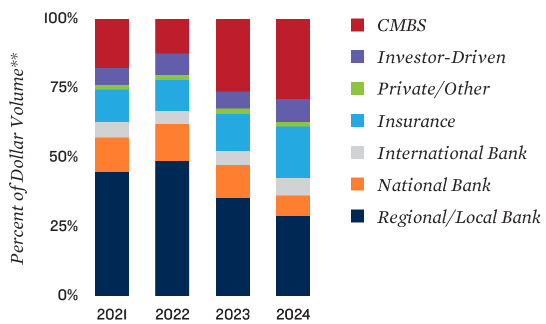


** Major CRE sectors include multifamily, industrial, office and retail*
*** Trailing 12-month period ended in 2Q 2025*
Sources: Marcus & Millichap Research Services; CoStar Group, Inc.

Fed Balance Sheet at Five-Year Low



Retail Lender Composition



** Fed Funds Rate as of August; U.S. Treasury Securities as of July 31*

*** Sales $2.5 million and greater*

Sources: Marcus & Millichap Research Services; CoStar Group, Inc.; Federal Reserve; Federal Reserve of St. Louis; Real Capital Analytics

Fed Faces Challenging Road Ahead, Even With Expected Shift in Monetary Policy

Rate cut anticipated as 10-year Treasury seesaws. Although the Federal Open Market Committee held the overnight lending rate at 4.25 percent through the first eight months of this year, a September rate cut is anticipated by financial markets. Downward revisions to recent months' employment growth and a more evident slowdown in consumer spending are set to prompt the change in monetary policy. Still, the risk of tariff-driven price increases remains. PCE inflation was up to 2.6 percent year over year in June, and the Producer Price Index rose at its fastest pace in more than three years in July. The upward trajectory of both indicators is likely to complicate the Fed's decision-making beyond September, as the Trump administration's more stringent stance on immigration and services-related inflation will potentially raise prices and slow economic growth. While a 25-basis-point cut to the overnight rate would be helpful, a significant increase in near-term borrowing activity is unlikely, due to long-term interest rates remaining elevated. After falling to 4 percent in April, the 10-year Treasury rate has hovered in the low- to mid-4 percent range through mid-August — a reflection of uncertainty among investors surrounding the long-term impacts of tariffs and demand for U.S. debt. In the months ahead, less foreign demand for U.S. debt and the potential for rising prices are likely to keep long-term rates heightened. As such, narrow windows to secure financing may exist for borrowers.

Liquidity heading in a positive direction. The increase in retail transactions registered during the second quarter of 2025 triggered a roughly 30 percent improvement in sector-related lending. Financing was available from a range of sources during the span; however, CMBS, life insurance companies, and regional and local banks continued to make up the bulk of lending. Looking to the second half, capital markets are poised to open up modestly, despite the retail sector's exposure to macroeconomic fluctuations. Regional and local banks should stay the primary sources for many private investors seeking single-tenant assets and smaller unanchored shopping centers. CMBS and life insurance companies, meanwhile, are expected to maintain an active, though selective, approach that places a preference on shopping centers with high-credit anchor tenants and portfolios of single-tenant net-leased assets. Average leverage from these lenders is likely to range from 55 percent to 65 percent. Borrowers seeking higher LTVs may look to investor-driven sources, including debt funds with dry powder. These entities' ability to lend at higher leverage, along with their ability to fill gaps in the capital stack via mezzanine debt or bridge loans, may make them the most viable option for certain investors.

Retail Division

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Sources: Marcus & Millichap Research Services; CoStar Group, Inc.; Federal Reserve; Federal Reserve Bank of Atlanta; Federal Reserve of St. Louis; Mortgage Bankers' Association; Placer.ai; Real Capital Analytics; U.S. Bureau of Labor Statistics; U.S. Census Bureau