The Resiliency of Retail

ARA Research

In the late 2010s, the demise of retail was top of mind for many investors: consumer spending had shifted to the internet, retail vacancies were at all-time highs, and the shopping mall was considered a dinosaur relic. Just five years later, retail has shown resiliency and is now among the top-performing sectors in investor portfolios.

We explore how drop-offs in construction, shifting retailer strategy, and consumers' desire to still experience brick-and-mortar stores has allowed retail to prove its durability.

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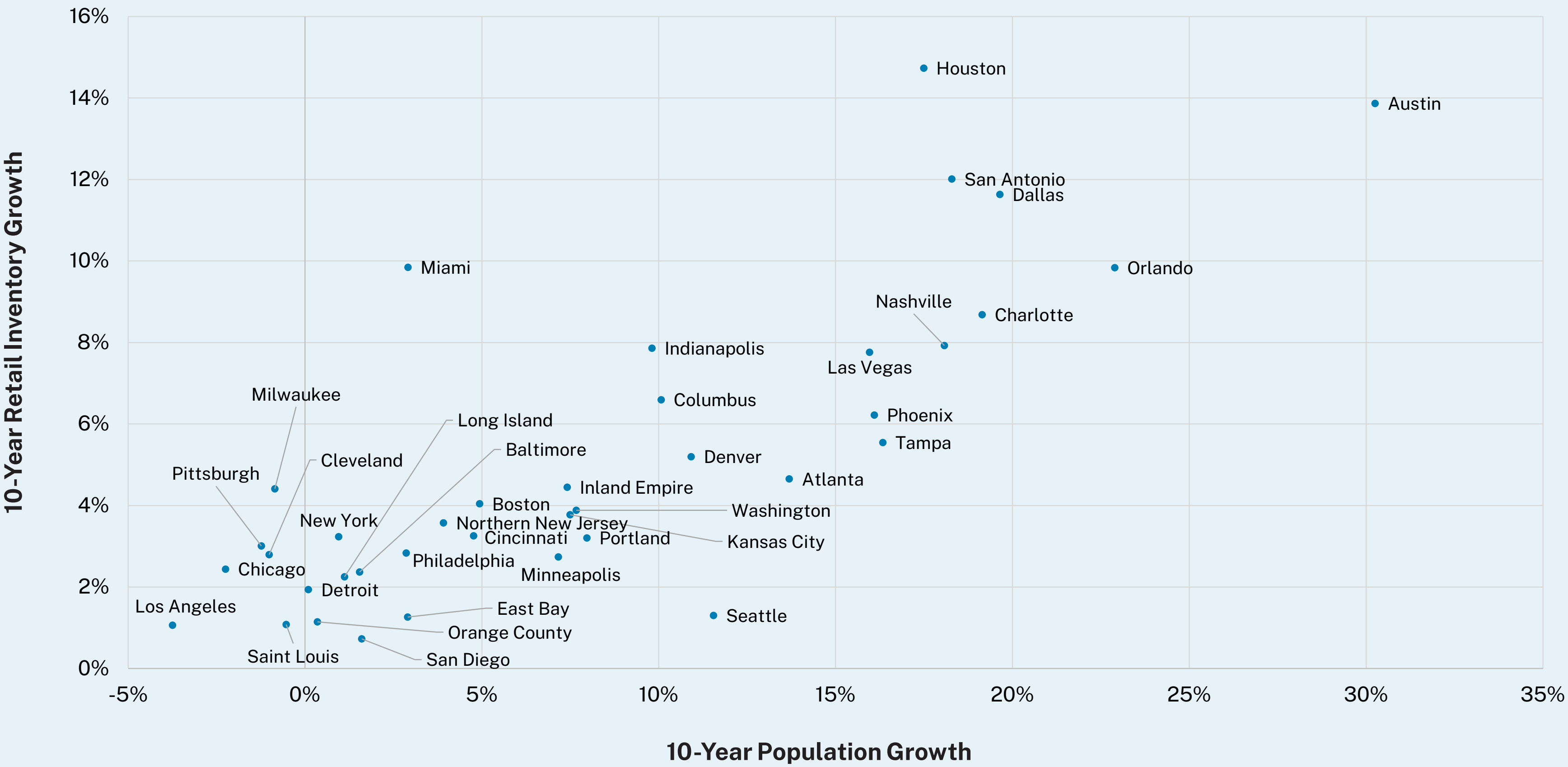
A Right Sizing of Retail

One of the key drivers of the then-dubbed "Retail Apocalypse" was a surplus of retail space as consumers began to purchase more products online. The ensuing steep drop off in new retail development has reversed the tide – according to CoStar, over the past decade, the average retail space per capita in the U.S.'s 75 largest markets has decreased by 1.9%, falling to 58.9 square feet per person. This reduction reflects a broader trend where more than 60% of major markets have seen population growth that is outpacing the growth in retail space. This discrepancy is particularly evident in Sun Belt cities such as Austin, Dallas, Orlando, Jacksonville, Charlotte, and Nashville, where population growth has exceeded retail inventory growth by 5% or more.

FIGURE 1

Population Growing Faster Than Inventory in Most Markets



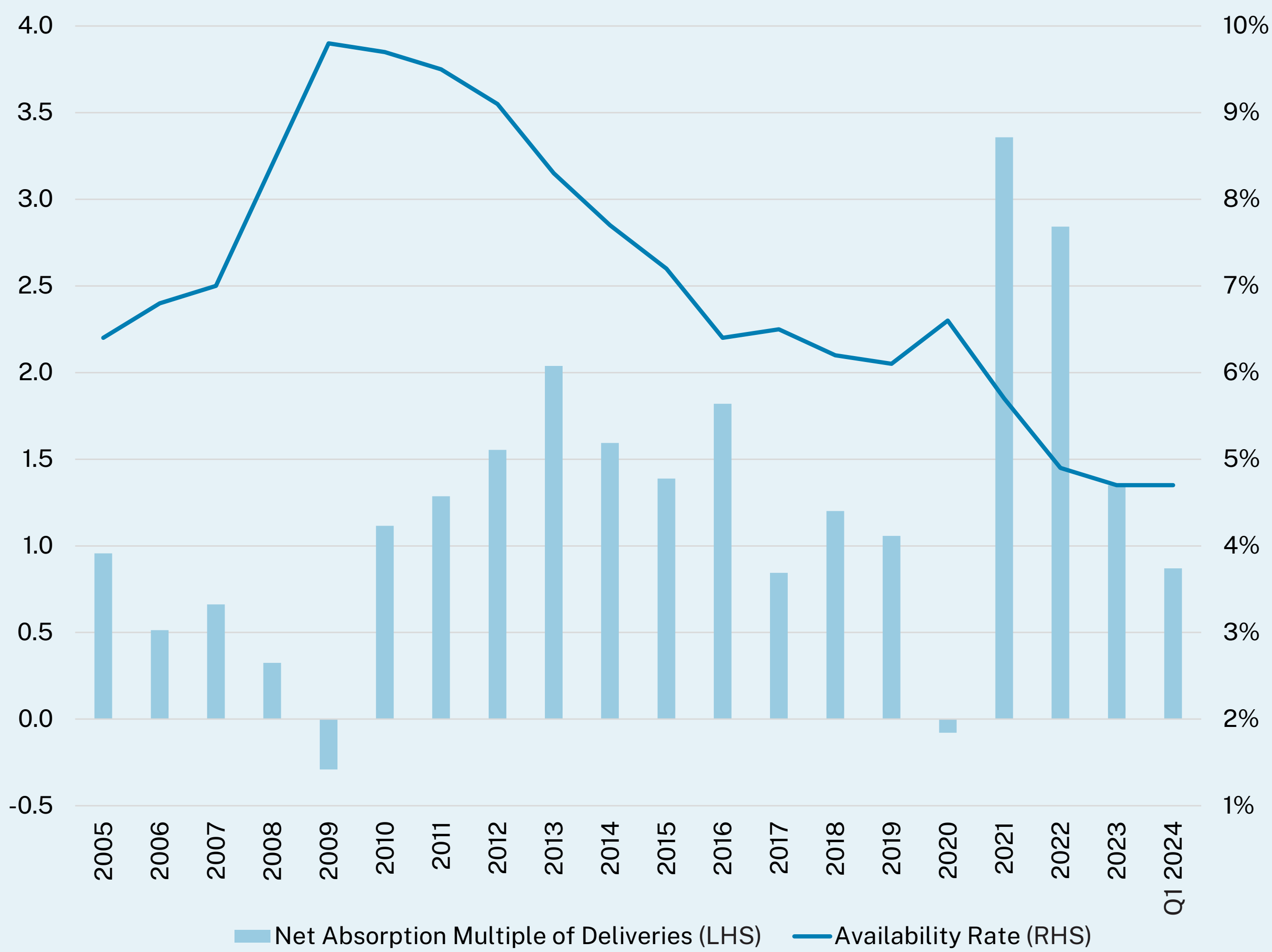
Source: CoStar, June 2024. Note: Includes only markets with at least 50 million square feet of inventory.

This supply and demand trend can be seen in contrast with high-cost Coastal and manufacturing driven Midwestern markets, which have both experienced population stagnation or decline. Despite limited new development, these areas still have relatively high levels of retail space per capita. This surplus results from historical patterns of expansive retail development during boom periods, which now lead to higher vacancy rates and underutilized properties. The challenge for these markets lies in repurposing or re-leasing these surplus spaces.

Overall, we expect these trends to continue and development to increase in the Sun Belt markets over the next several quarters, while a conscious effort to repurpose space in the Coastal and Midwestern markets continues to be underway. We see the repurpose of space through the increase in specialty and non-traditional retail, as well as the redevelopment or repositioning of outdated malls and strip centers in these regions. We expect these factors to continue to support the overall growth of the retail sector as retailers and landlords continue to innovate and adjust to shifting trends.

FIGURE 2

Appetite for New Retail Space and Retail Activity



Source: CBRE Econometrics Advisors, Q1 2024.

Redefining Retail

Retail real estate subsectors have experienced a substantial transformation, particularly in the wake of the pandemic. According to a recent CoStar report, nearly 50% of all retail spaces leased over the past year were occupied by tenants outside the traditional retail sector. This shift reflects a broader trend where diverse types of businesses, from wellness retailers such as Glowbar, Skin Laundry, and Drybar, to experiential concepts such as F1 Arcade and Ace Hardware's 'Elevate' concept, are occupying space. This evolution is driven partly by a surge in consumer spending post-pandemic, which has heightened the demand and created a more efficient operating environment for a broader variety of tenants. To cater to these new consumer preferences, physical retail spaces are being redesigned to enhance the shopping experience, incorporating features like interactive displays, dining options, and wellness features.

While the increased appetite from a new subset of users is a net positive for the retail sector, it is not without risks to owners and operators. These concepts may be relatively untested in a market or lack the credit quality of the major national retailers, increasing go-dark risks. These tenants may also seek shorter lease terms, which shortens weighted average lease terms (WALT) of properties and could adversely impact valuations. However, successful integration of diverse retail offerings can also drive foot traffic and positively influence the performance of other retailers within the investment, potentially offsetting some of these risks.

Pop-Up Activations and Shop-in-Shops

Pop-ups involve temporary stores that cater to short-lived trends and seasonal offerings – think Halloween stores – but may also be used by retailers testing out new concepts or evaluating a new market. These offerings create opportunities to temporarily backfill vacant spaces and can be used to generate short-term cash flow.

Experiential Retail

Unlike many other brick-and-mortar offerings, experiential retail stores' primary focus isn't sales of goods, but rather on selling opportunities to experience something engaging. This can include immersive "Instagram-worthy" spaces that are created with the purpose of offering users fodder for their social media feeds, as well as activity-based spaces like TopGolf. Experiential extends to more traditional retailers as well; brands have leaned into in-store events that capture customers for longer, create stronger brand loyalty, and promote visits beyond their normal purchasing habits.

Grocery and Food Anchors

Grocery-anchored retail centers continue to demonstrate remarkable resilience in today's retail landscape, buoyed by evolving consumer habits and a robust demand for essential goods. Recent data underscores the sector's stability, with grocery-anchored centers enjoying a higher foot traffic compared to their non-grocery counterparts. According to a 2024 report by CBRE, these centers have experienced a 5% increase in average sales per square foot over the past year, attributed to the sustained necessity of grocery shopping and a resurgence in in-person shopping experiences.

What It Means for Investors

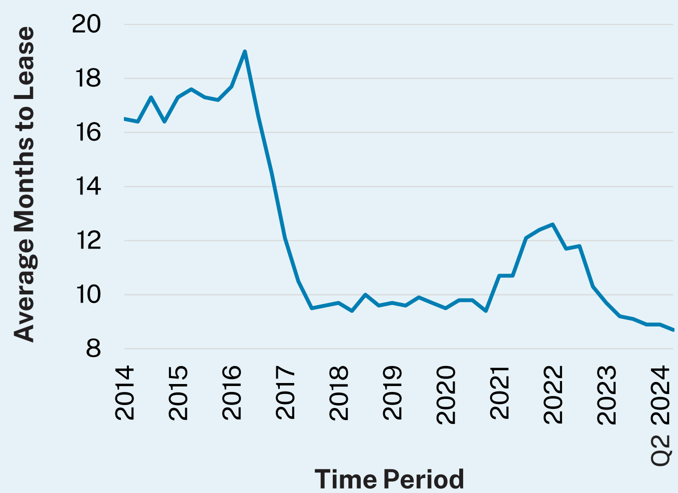
The decrease in availability of space, as well as the multitude of new uses coming to the forefront, is positive news for investors. According to CRE Daily, the pace at which leases are being signed is at a 20-year low of just 8.5 months on average to find tenants for newly available shopping center spaces, with 80% of shopping center spaces being leased within 6 months. 98% of retail spaces are leasing within 9 months.

While challenges remain, the adaptability and innovation within the sector are promising signs of its ongoing resilience. Retail spaces in growing population centers should continue to thrive with the strategic development and considerations for new space. While the successful integration of experiential elements, innovations, and thoughtful repurposing of space should allow for Coastal and Midwestern markets to remain steady.

The sector's ability to reinvent itself in the face of changing consumer preferences and economic pressures underscores its enduring strength. As retail continues to transform, we see the sector poised to remain a vital and dynamic component of real estate portfolios.

FIGURE 3

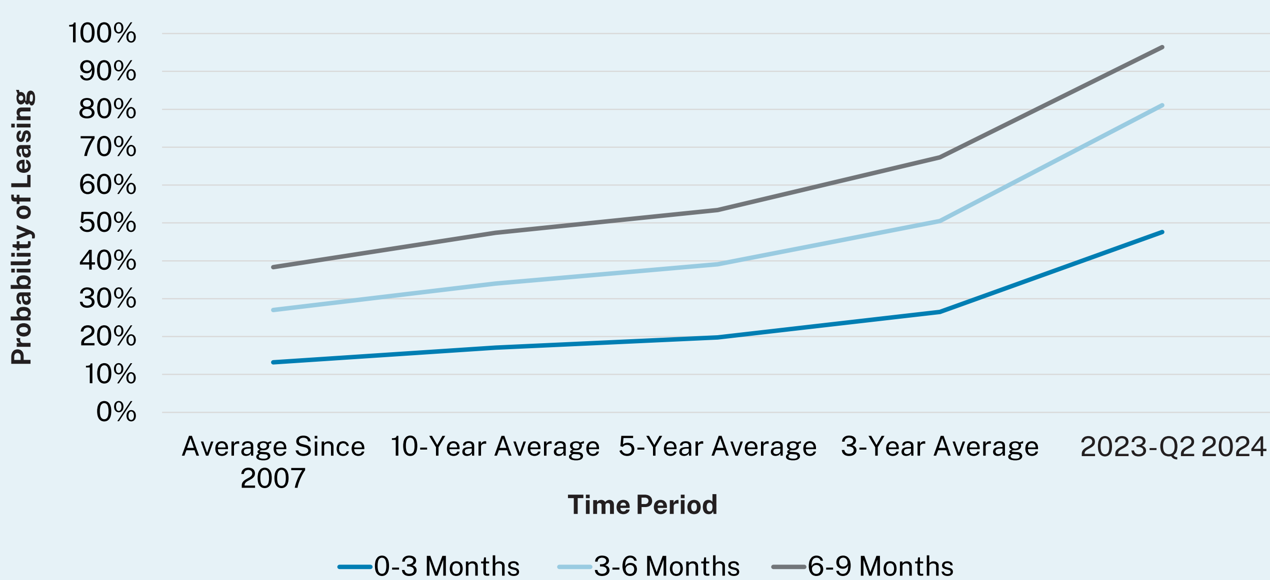
Average Time for Retail Space to Lease Hits Decade Low



Source: CoStar. Note: Includes all shopping center types except malls.

FIGURE 4

Majority of Retail Spaces Are Leasing Within Six Months



Source: CoStar, June 2024. Note: Represents the percentage of on-market space leased during the listed period.

Disclaimer

Forward-Looking Statements

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