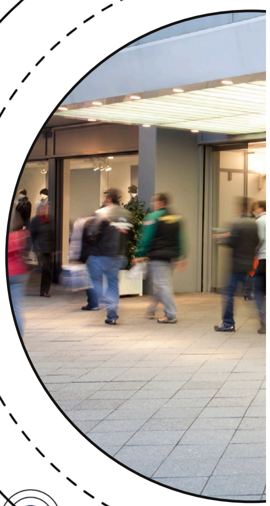
SVN RESEARCH

State of the Market 2024

RETAIL

Retail



NATIONAL OVERVIEW

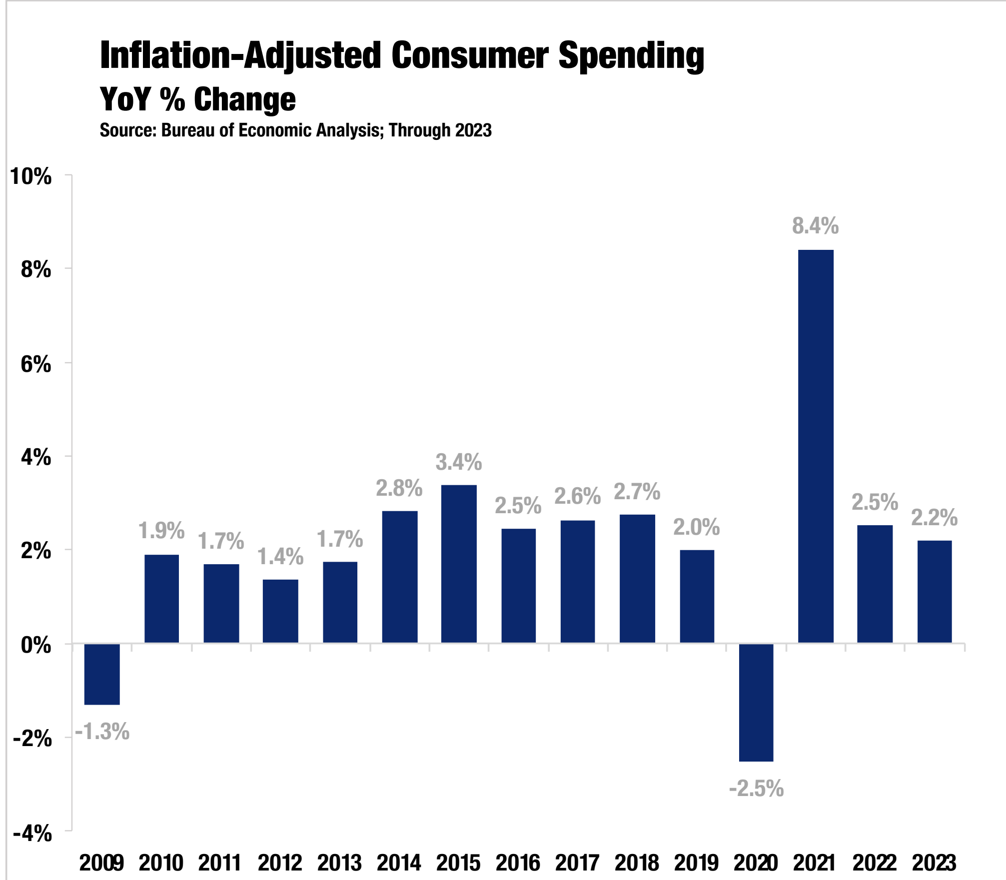
To paraphrase Winston Churchill, if you're going through a rough patch, your best bet is to keep on going. The retail sector has done just that, and now the temperature gauge is starting to look more friendly.

Once commercial real estate shook off the rust post-Great Recession, the retail sector became the consistent laggard of the bunch. The structural reality is that the US had an oversupply of the wrong kinds of retail, which resulted in a painful rightsizing. However, it has also meant that the retail was better positioned for the subsequent real estate downturn, which we are experiencing now.

Make no mistake, the retail sector still has pockets of weakness. Malls have seen a clear bifurcation, where high-quality assets are outperforming, and class B & C properties have struggled. A downstream impact of remote work and fewer employees in office towers. As a result, urban retail in central business districts has also faced challenges.

However, by and large, **the retail sector is emerging as a darling of the current market environment.** The fact that retail construction has remained muted for so long has meant that there is minimal excess supply requiring absorption. Moreover, national vacancy rates finished the year below 5%, revealing a hyper-competitive market for available space. Also underpinning the resilient success of the retail sector last year was the surprising strength of the US consumer.

Entering 2023, a recession appeared investable. The January 2023 Economic Forecasting Survey, which polls the nation's leading economists, put the probability of a downturn last year at 61%. Nevertheless, even while lacking optimism, consumers kept their foot on the gas. **After accounting for inflation, consumers purchased 2.2% more goods and services in 2023 than they did the year prior.**



The retail sector is grappling with the high cost of capital impacting all other sectors, which is translating into some softness in pricing. However, beyond the interest rate environment, cyclical and structural factors remain supportive. **More residential demand in the suburbs has meant that neighborhood shopping centers are in a renaissance.** Further, the growing demand for fitness, lifestyle, and other experiential retailers is a boon for the sector across all geographies. **All else equal, the picture within the retail sector is among the most positive in the CRE ecosystem.**

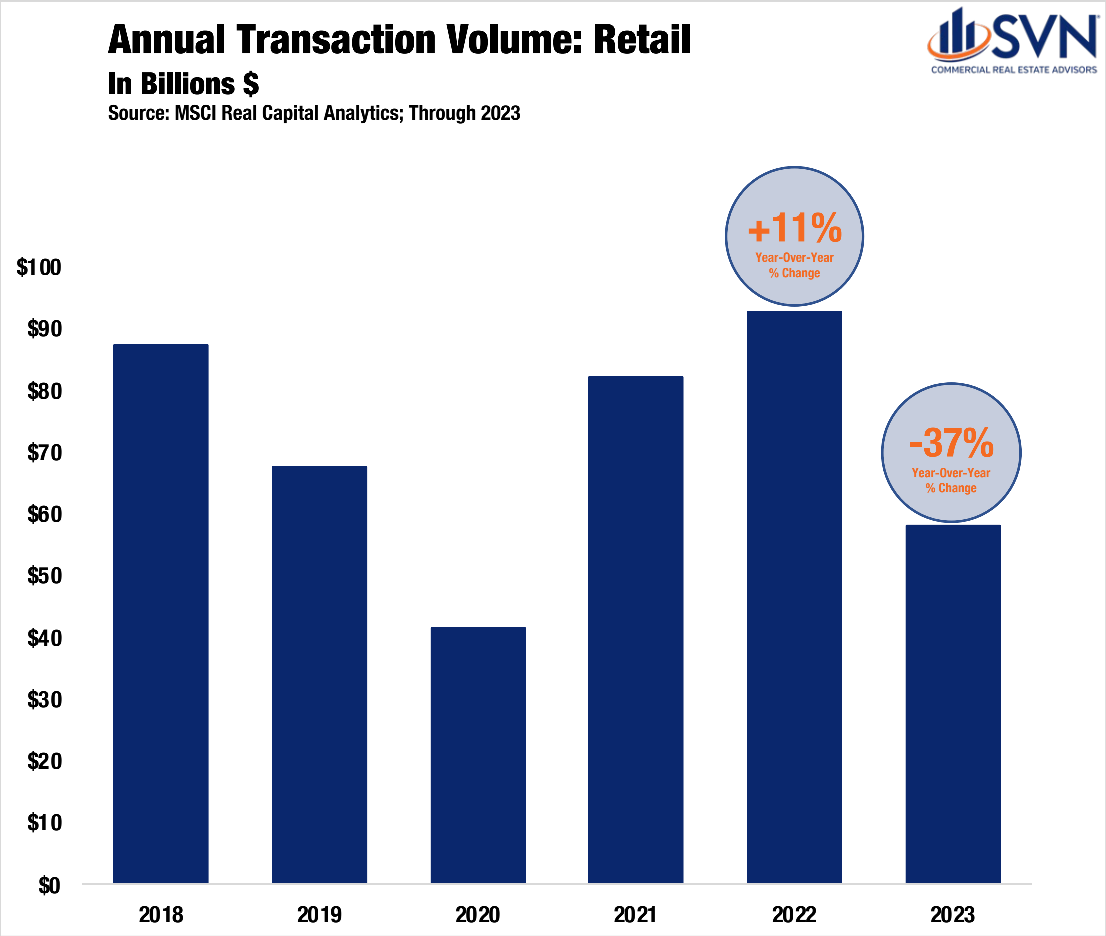
Financials

RETAIL: TRANSACTION VOLUME

According to MSCI Real Capital analytics, retail transaction volume totaled $58.0 billion in 2023 — decreasing 37% from the previous year.

While the year-over-year transaction volume decrease was the most severe dip the retail sector has seen since 2008, it proved the most resilient of the core four property types. Every other core property type saw a drop of at least 44%.

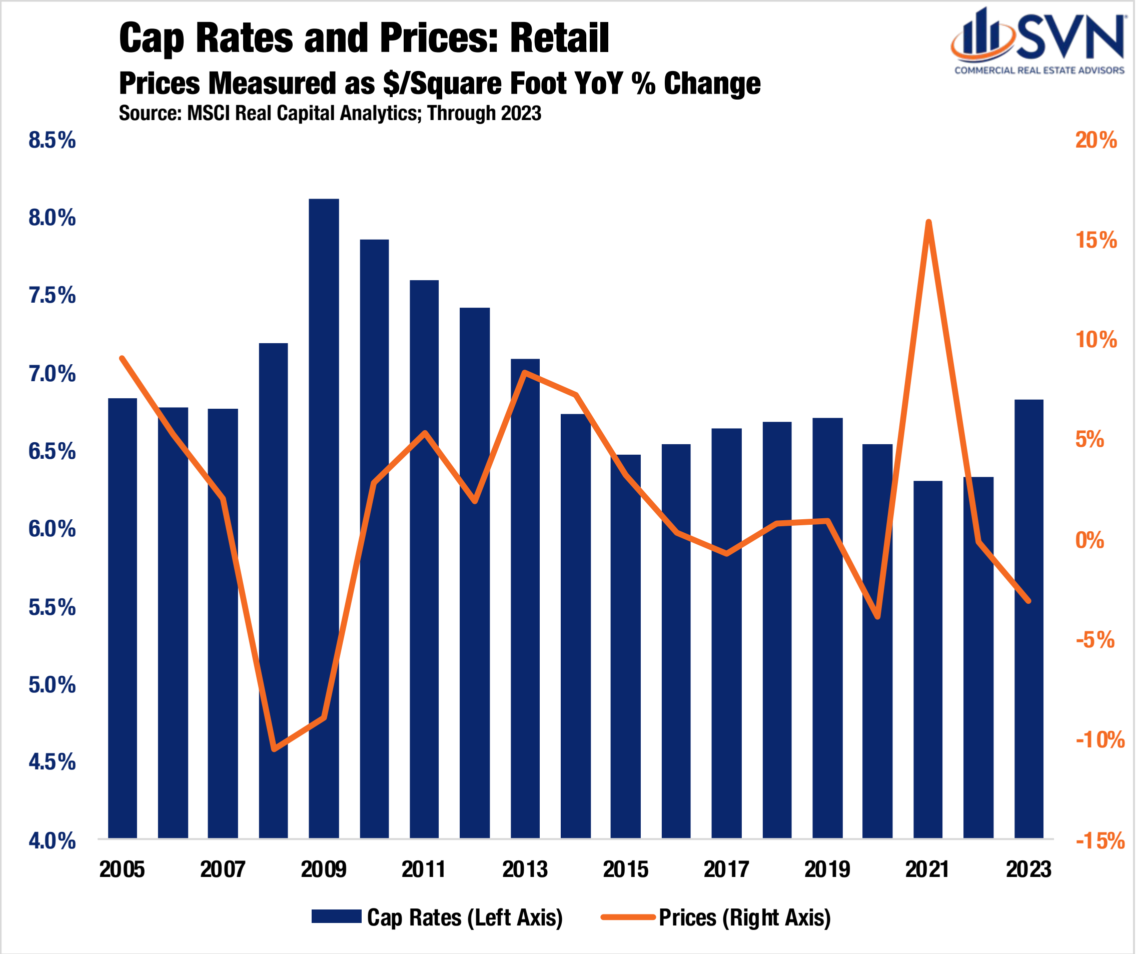
The fact that the sector was already experiencing a secular reorganization when the pandemic hit has made it better positioned for the current moment. **Simply put, the sector had less rightsizing left to do than others.**



RETAIL: CAP RATES AND PRICES

Cap rates in the retail sector followed the trend observed throughout the rest of commercial real estate. **In total, cap rates rose an average of 50 bps across the sector, rising to 6.8%.** The one-year increase was the largest on record since the Great Financial Crisis in 2008.

However, while most other CRE asset types are seeing property-level yields that have been uncommon for a decade, the current cap rate environment looks less foreign within the retail sector. Retail cap rates averaged 6.7% as recently as 2019.



Regional Performance

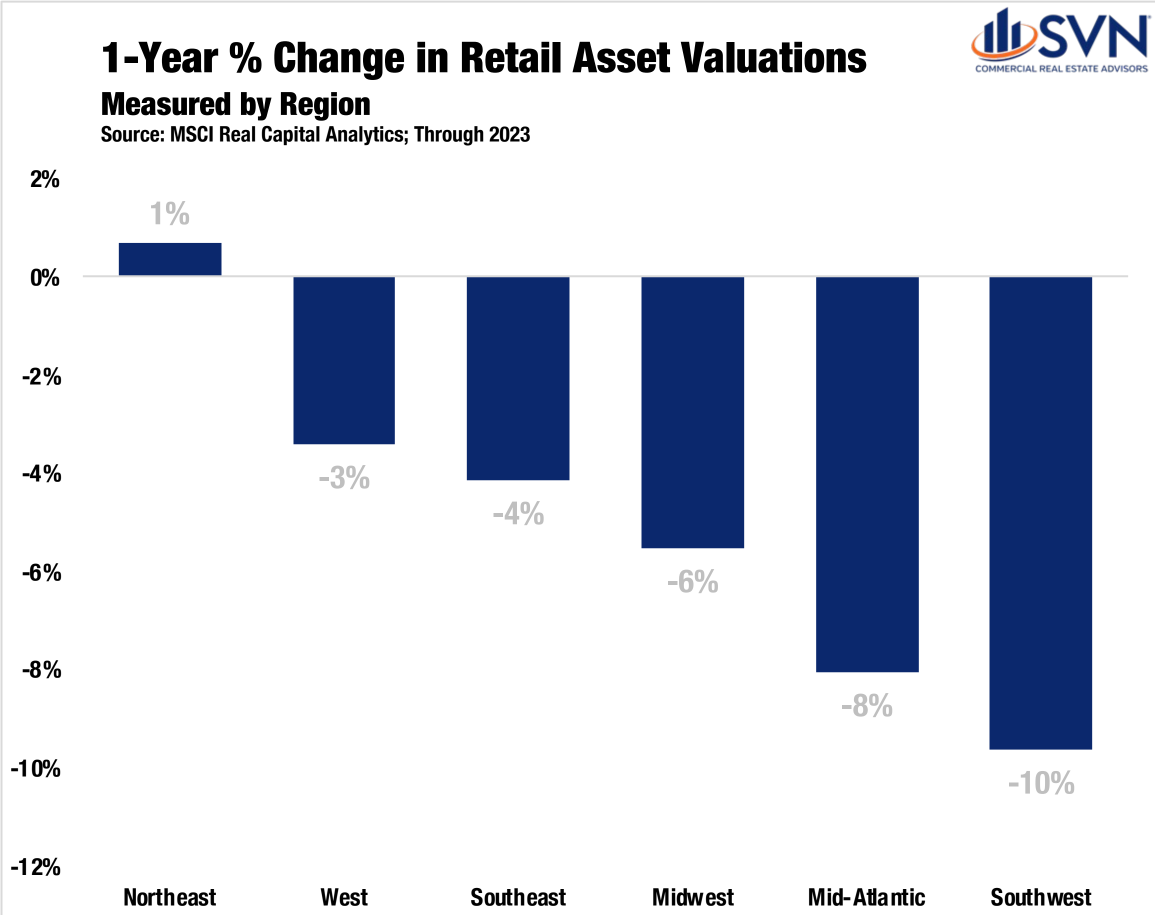
In the development of the retail regional rankings, the SVN Research Team utilized a scoring matrix. The matrix offers a comprehensive view of how regional markets are performed within the context of growth from a year earlier. The three following criteria were included in the matrix:

1. Transaction Volume: 1-Year % Change
2. Cap Rates: 1-Year Change
3. Pricing: 1-Year % Change

2024 Regional Market Rankings: Retail

Source: SVN Research, MSCI Real Capital Analytics; Through 2023

Rank	Region
1	Northeast
2	Midwest
3	West
4	Southeast
5	Mid-Atlantic
6	Southwest



TOP PERFORMERS: NORTHEAST

Let's take a stroll down 5th Avenue. Looking at the data, the Northeast retail sector experienced a relatively benign 2023.

However, given the context of CRE and market volatility in most other property types and geographies, benign sounds pretty darn impressive. **According to MSCI Real Capital Analytics, pricing improved in Retail transactions from $472 per square foot (PSQFT) in 2022 to $475 PSQFT in 2023.**

Notably, the Northeast was the only region not seeing declining retail asset prices last year.

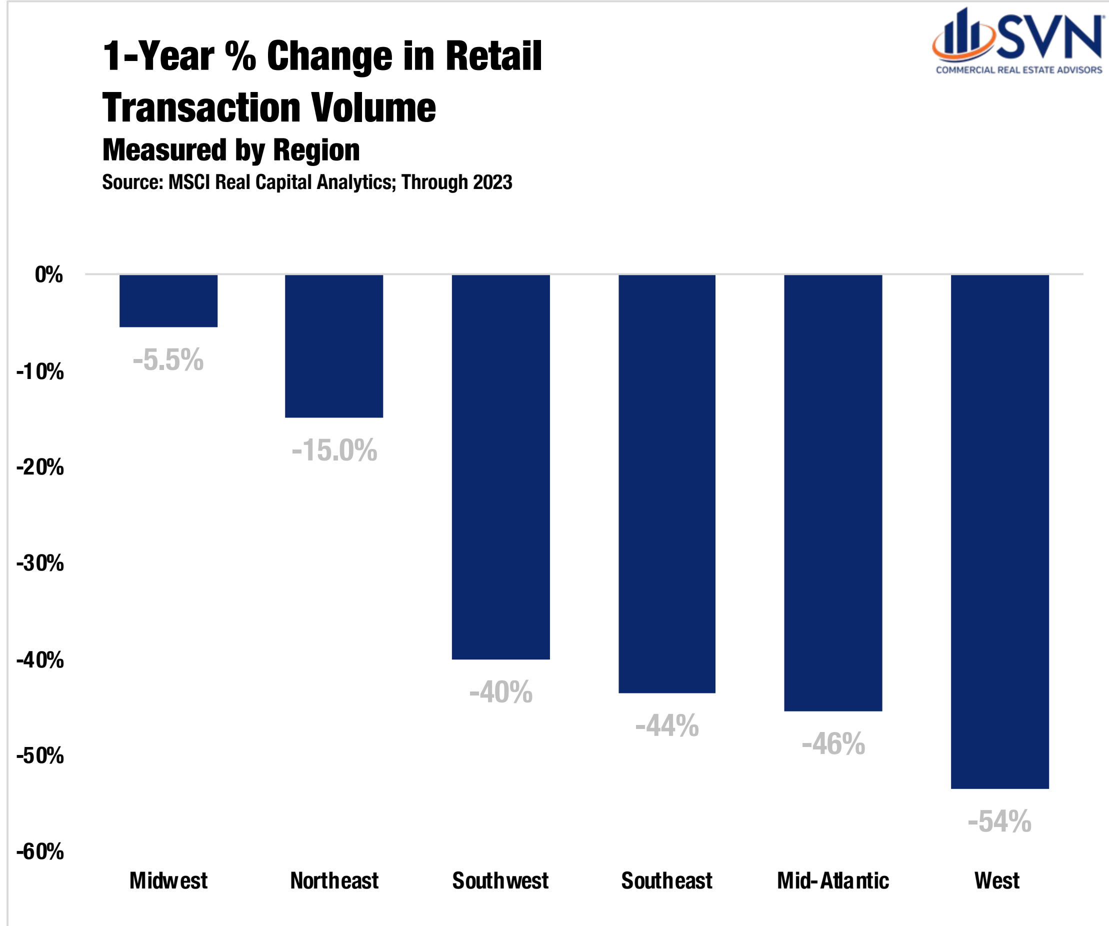
Retail in tertiary parts of the region performed best for pricing in 2023 (+5.3%), though markets such as Long Island (+2.9%), Westchester (+2.5%), Manhattan (+2.4%), and Boston (+2.2%) all saw noteworthy gains. Cap rates rose an average of 35 bps in the Northeast in 2023 — the second-smallest increase next to the West. Further, the Northeast also saw the second-smallest decrease in deal volume, dropping off just 15.0% year-over-year.

TOP PERFORMERS: MIDWEST

We can probably thank Chicago for the winds pushing the Midwest Retail sector along. **The Midwest stands out in part thanks to its resilient deal flow.**

According to MSCI Real Capital Analytics, $11.8 billion of Retail assets changed hands in the Midwest last year — registering just a 5.5% decrease from the year prior. After accounting for just 13.5% of all US Retail deal activity in 2022, the Midwest's share jumped to 20.4% as every other region experienced a more intense transaction pullback. Retail cap rates in the Midwest saw a middle-of-the-pack increase of 42 bps, though several key markets performed considerably better.

The Columbus retail sector was a rare case of average cap rates declining in 2023 (-11 bps). Kansas City (+17 bps), Minneapolis (+22 bps), and Detroit (+24 bps) also all saw cap rate movements that were milder than the region and country as a whole.



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