NATIONAL REPORT

Marcus & Millichap

SINGLE-TENANT NET-LEASE RETAIL

1H/24

Backstopped by Standout Fundamentals and Consumer Durability, Single-Tenant Properties Remain Well Positioned

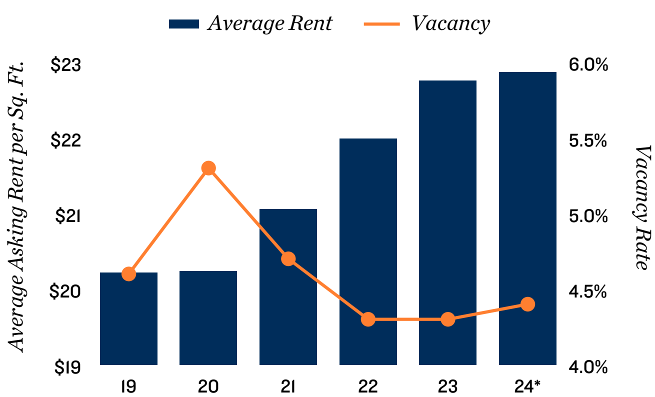
Sector retains title of least vacant commercial real estate segment. As of March, the number of major U.S. markets with sub-4 percent single-tenant vacancy matched the count from the same period five years ago, with national vacancy down 10 basis points during that stretch. So far this year, the labor market has exceeded expectations and supported real term increases in retail spending, with a new benchmark for quarterly core retail sales set during the first three months of 2024. While inflation and budget tightening are influencing more households to prioritize necessities, consumers are also reserving more of their incomes for eating out and experiences, a dynamic that is aiding foot traffic and patronage at net-leased retail spaces. Should these trends continue amid a pullback in construction and historically low vacancy, it will reinforce positive leasing activity and prompt retailers to execute expansion initiatives.

Broad demand for space apparent. Every major single-tenant category outside the drug store segment recorded little or no vacancy adjustment over the past year ending in March, with the fast food, convenience store and restaurant sectors all entering the second quarter with sub-3 percent rates. Strong retailer demand for net-lease space is also evident across market types. Primary and secondary market vacancy was unchanged during the past year, holding at 4.6 and 4.3 percent, respectively. Tertiary vacancy is even tighter, having compressed 10 basis points to 3.5 percent. This general tightness will aid owners when executing lease renewals or attempting to secure new tenants.

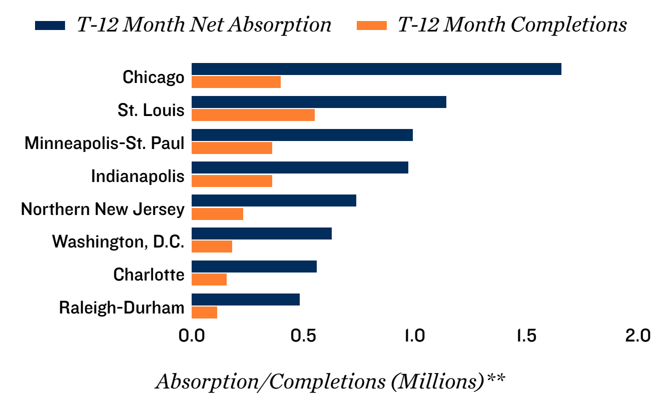
Benefits of net-lease investment outweigh hurdles. Single-tenant trades accounted for nearly one-fourth of all primary commercial real estate deal flow over the 12-month period ending in March, with the transaction count exceeding any annual total prior to 2016. Most closings sold for $1 to $10 million, indicating notable private investor activity. For these buyers, the sector provides numerous positives, especially for those seeking less management-intensive assets during a period of rising operating costs. With the Federal Open Market Committee holding the benchmark rate at a lower bound of 5.25 percent in May and buyer-seller expectations falling into better alignment, investors looking to sidestep financing hurdles may list holdings with the goal of reinvesting proceeds into net-leased assets. For single-tenant borrowers, local and regional banks will remain primary financing resources; however, the sector's strong fundamentals may support a more diverse lending platform.

Attractive options abound for buyers. Among the 50 major U.S. retail markets, 34 entered April with a single-tenant vacancy rate at least 100 basis points below their long-term mean — a list that is heavily populated by Midwest, South and Texas metros. This tightness will steer capital to these regions, with Dallas-Fort Worth, Chicago, Houston, Atlanta and Tampa likely to rank as top markets for closings. Phoenix, Las Vegas and Charlotte, high-growth markets where net absorption is exceeding delivery volume, will also garner attention. Capital appears to be returning to California as well, as the state's eight major markets and the Central Valley accounted for a larger share of total deal flow over the past year.

Vacancy and Rent Trends



Supply vs. Demand Standouts



** As of 1Q; average asking rent up 13.1 percent since year-end 2019*

*** Net absorption and completions totals for trailing 12-month period ending in 1Q 2024*

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

Bankruptcies Impact Drug Store Vacancy, Nominal Shifts Noted Across Other Subsectors

Property Type	Inventory*	Vacancy Rate*	Y-O-Y Basis Point Change*	Trailing 12-Month Net Absorption*	Performance Highlights
Restaurant	704M sq. ft.	3.7%	0	2.6M sq. ft.	Six straight quarters of 3.7 percent vacancy
Supermarket	597M sq. ft.	2.2%	10	3.5M sq. ft.	Sub-3 percent vacancy since 4Q 2017
Department Store	553M sq. ft.	6.4%	10	523K sq. ft.	Vacancy in the 6 percent range since 1Q 2021
Fast Food	241M sq. ft.	1.3%	10	1.4M sq. ft.	Sub-2 percent vacancy since 2Q 2011
Drug Store	200M sq. ft.	3.1%	100	-1.9M sq. ft.	Highest vacancy since year-end 2005
Convenience Store	171M sq. ft.	1.2%	10	1.5M sq. ft.	Low-1 percent vacancy since 2Q 2021

** As of 1Q*

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

Store Closures Generate Growth Opportunities for Other Retailers

Headline-grabbing moveouts distract from sizable pool of expansion-minded chains. A round of store closures will take place this year, with Rue21, 99 Cents Only and Sam Ash the most recent brands to announce across-the-board shutterings. Still, it remains plausible that store openings will surpass closures, with near-term moveouts creating an opportunity for other retailers during a period of limited vacancy and minimal retail construction. Expansion-minded Academy Sports + Outdoors, Boot Barn, Dollar General, Five Below, Ross Dress for Less and Burlington all represent candidates to lease or sublease spaces currently being vacated nationally by the likes of Walgreens, CVS, Rite Aid and Family Dollar. Available smaller net-leased spaces, meanwhile, should attract significant attention from a collection of quick-service companies, as modest construction and a lack of space options suitable for these tenants may alter certain chains' expansion timelines. Companies that are plotting notable growth this year that may encounter this hurdle include Jersey Mike's, Chipotle, Raising Cane's, Bojangles and Dutch Bros.

Grocers represent a primary candidate to backfill space. A focal point for consumers, supermarkets observed record spending in March. This encouraging sales tally and generally stable grocer foot traffic over the past three years has many supermarket chains plotting growth with the goal of reaching new and specific consumer bases. The 2.8 million square feet of grocery space slated for delivery this year — the lowest total since at least 2000 — and low-2 percent subsector vacancy, however, indicate many of these chains will accomplish their plans through backfilling existing properties larger than 10,000 square feet. Publix, H-E-B and Hy-Vee are among the chains currently executing regional expansions, with Aldi, Grocery Outlet, Sprouts Farmers Market, Trader Joe's and Whole Foods each planning to grow their store counts this year.

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Sources: Marcus & Millichap Research Services; Coresight Research; CoStar Group, Inc.; National Retail Federation; U.S. Bureau of Labor Statistics; U.S. Census Bureau