NATIONAL REPORT

Marcus & Millichap

SINGLE-TENANT NET-LEASED RETAIL

2Q 2022

Brick and Mortar Retailers Pivot as Store-Based Spending Improves; Investors Cautiously Optimistic on Single-Tenant Sector Amid Inflation and Rising Rate Environment

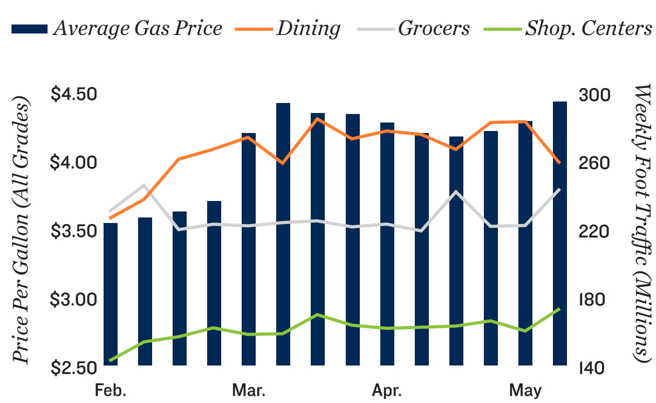
Economic tailwinds aid outlook for tangible retail. The single-tenant sector is at a junction as the second half of the year approaches. Despite inflation and rising fuel prices, during the early months of 2022 retail spending gains have been widely distributed across store-based segments, which excludes purchases made online or at bars and restaurants. This suggests a broader shift in consumer behavior is ongoing, one with an emphasis on physical locations. Reflecting heightened in-person shopping activity, store-based retail sales accounted for nearly two-thirds of all core retail spending in March and April, and inflation-adjusted core retail sales are up nearly 18 percent compared to pre-pandemic recordings. Vendors are responding by bolstering staffs, with 284,000 more people working in retail today than prior to the health crisis. Store-based sales momentum has the potential to remain positive moving forward, as U.S. households have more cash savings than debt, and the economy is expected to recoup all jobs lost during the pandemic by this summer. Companies will accomplish the latter by augmenting pay to fill open positions, supporting overall income growth.

Record high gas prices impact consumers' decisions. The ongoing stretch of elevated fuel costs that began in February is changing how households shop. Some are making fewer trips to grocers and other necessity-based stores, while increasing the number of items purchased per visit. Others are frequenting restaurants and fast-food chains closer to where they live, rather than travel to downtowns. This shift has aided suburban retail, with overall vacancy outside core locations falling below the CBD during the first quarter for the first time on record. All-time high gas prices may also alter Americans' travel plans. Households intent on vacationing in their personal vehicles this summer may adjust trips if the average gas price holds above $4 per gallon, adversely impacting retailers in tourism destinations.

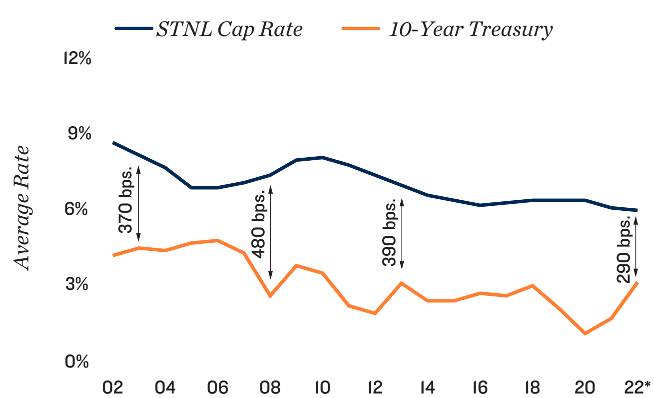
Vendors evolve by shifting size of footprints. Responding to shifts in consumers' expectations and shopping habits that were accelerated by the pandemic, a mix of single-tenant retailers are reinventing themselves to support market expansion and capture new audiences. Small-store formats have emerged as a primary avenue to achieving these goals, a trend that has the potential to bolster competition for available space. Department stores, including Macy's and Bloomingdale's and supercenters like Meijer and BJ's Wholesale Club, have recently launched smaller-scale operations, backfilling 20,000- to 50,000-square-foot storefronts in population-dense urban settings and suburban neighborhoods. Shopping centers with smaller available floorplans are also benefiting from retailer evolution, as grocers like Fareway, Big Y and Schnuck Markets are occupying sub-20,000-square-foot spaces to unlock new market opportunities.

Collection of factors elevate single-tenant trading. Encouraging metrics in job creation, household savings and unemployment are bolstering the appeal of net-leased retail investment despite high inflation and downward pressure on cap rates across market types. Moving forward, owners of apartments may capitalize on high pricing in the multifamily segment and take the opportunity to sell into consistency, moving equity via 1031 exchanges into less management intensive single-tenant properties, including drug stores, that provide long-term cash flow. Recent deal flow suggests this movement is underway, as single-tenant sales activity rose by 45 percent over the past year ended in March. Many investors are focused on assets occupied by high-credit grade tenants that have exhibited resilience during the health crisis and can leverage scale to provide better value. For these buyers, major metros noting strong in-migration are targets, with competition for properties in outer suburbs poised to accelerate.

Fuel Costs Yet to Curtail Foot Traffic in 2022



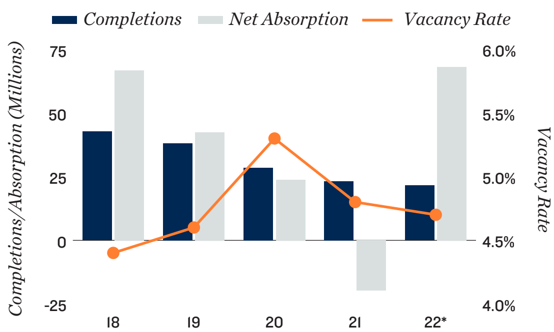
Single-Tenant Cap Rate Trends



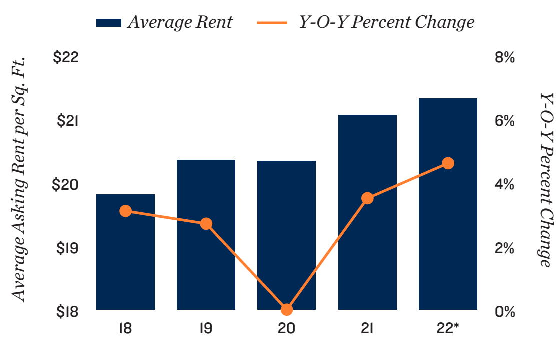
* Through May 12

Sources: CoStar Group, Inc.; Federal Reserve; Placer.ai; Real Capital Analytics; U.S. Energy Information Administration

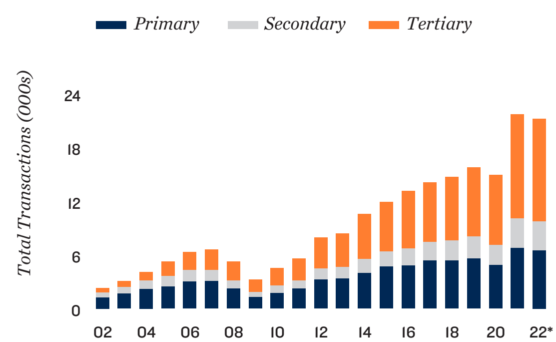
Single-Tenant Supply and Demand



Single-Tenant Rent Trends



Single-Tenant Sales Activity by Market Type



** As of 1Q; trailing 12-months through 1Q for completions, absorption and rent*

Sources: CoStar Group, Inc.; Real Capital Analytics

Suburban Strength Solidifies, CBD Improves

Availability returns to pre-pandemic mark. Single-tenant property performance continues to advance as greater consumer foot traffic and brick and mortar spending motivate retailer expansions. Entering April, sector vacancy nearly matched the year-end 2019 rate of 4.6 percent, with tenants absorbing more than 68 million square feet over the past 12 months ended in March. Expectations for construction to remain restrained over the near term suggests further vacancy compression is probable if additional vendors resume expansion plans and backfill available floorplans.

Catalysts for downtown recoveries in place. Suburban properties have highlighted the strength of single-tenant retail during the pandemic; however, downtown storefronts are positioned for near-term improvement. Nationwide, more firms are advancing their return-to-office plans at a time when the number of workers in traditionally office-using positions is the highest on record. This, along with the resumption of business travel and conventions, will heighten foot traffic and consumer spending in CBDs. An additional boon for downtown retail, CBD multifamily vacancy hit a 20-year low in the first quarter of this year, revealing strong renter demand for urban residences.

Buyers Expand Criteria to Include More Tertiary Listings

Quest for higher yields pushes private buyers to new locales. Strong single-tenant fundamentals are fortifying investor confidence in the sector, with shifting consumer behavior that favors brick and mortar stores motivating owners to expand portfolios. A survey of investors with retail holdings found more than half plan to increase their investment in the sector this year. Larger investors' pursuit of high-credit tenants and buildings with long-term leases will push more private buyers to the sub-$3 million tranche, with a higher percentage considering transitional assets and properties occupied by noncredit tenants that withstood the pandemic. Narrowing yields and record pricing may also influence private buyers to pursue listings in outer suburbs of major metros and properties in tertiary markets, where strong housing demand and above-average rent growth exist. Across the tertiary tier, single-tenant vacancy sat at 4 percent entering April, a rate at least 60 basis points below primary and secondary market recordings. Tight conditions suggest upside exists in tertiary locales, including San Antonio, Salt Lake City, Kansas City and California's Central Valley.

Net Lease Division

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Sources: Marcus & Millichap Research Services; U.S. Census Bureau; Moody's Analytics; Real Capital Analytics; Placer.ai; U.S. Energy Information Administration; M&M/WMRE Investor Survey