ASB Real Estate Investments | Retail

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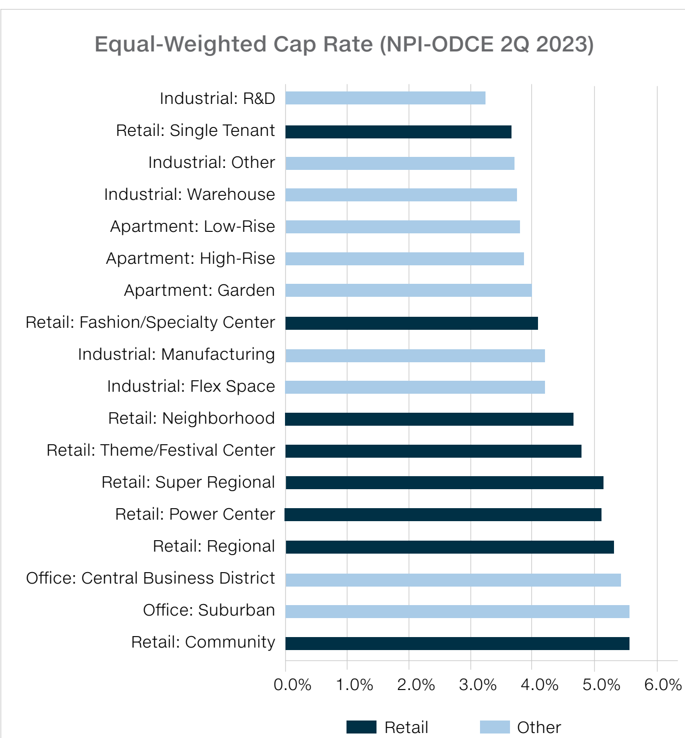
465 Broadway - New York, NY

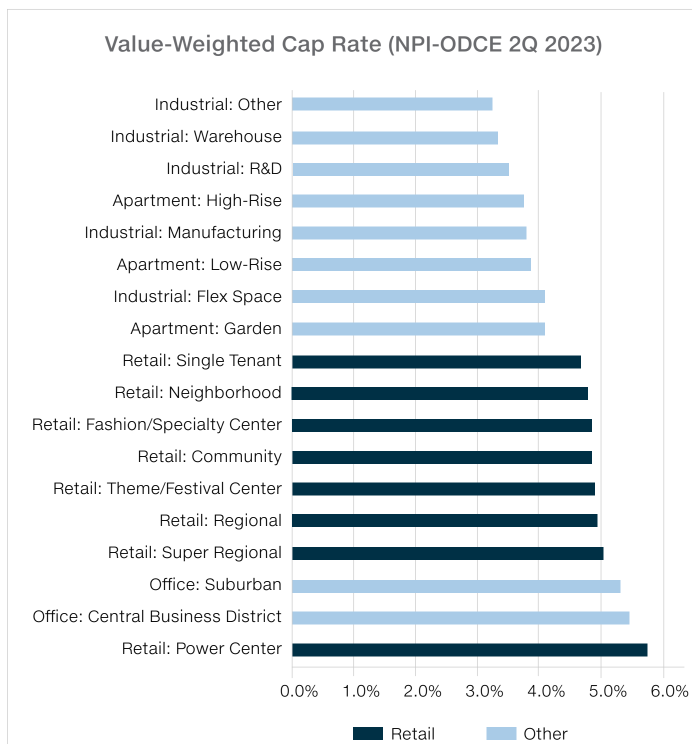
ASB LOOKS AT

Retail Real Estate's Rebound

Retail real estate has emerged from a pandemic accelerated downturn to rank as the top performing property sector in recent quarters as vacancy rates have constricted dramatically and investors have renewed interest. Although the growth profile of retail investments may be more limited compared to other real estate sectors, the attractive income yields and strong income-durability for the best positioned retail investments, still make the property sector an important staple in a core, diversified real estate portfolio **[see Exhibit A]**.

Exhibit A: Return Expectations





Source: NCREIF

Retail Resilience

In the years following the Great Recession, beginning in 2010, retail net absorption significantly exceeded supply, but by 2017 growing e-commerce market share began to undermine retail occupancy. Bankruptcies and store closures accelerated and investors began to shun retail as some projected unabated growth in e-commerce would render brick-and-mortar obsolete eventually. Retail dislocation only deepened in 2020 with the onset of the pandemic and annual store closures accelerated to more than 12,000 by 2020.[1]

But emerging from the Covid lockdown, consumers flush with government stimulus checks and pandemic savings stepped up shopping, dining, and travel. In response, retailers took note—in 2021 net store openings registered in positive territory for the first time in more than a decade **[see Exhibit B]** and the national vacancy rate has dropped to 4.2% as of the second quarter 2023, a record low.[1,2] Retail landlords have also enjoyed better credit quality and lower delinquency rates as the pandemic weeded out weaker tenants.

Cautious Optimism for Consumer Health

Although retail sales growth has moderated recently, consumer spending levels remain elevated and have held relatively steady post-pandemic. And despite a precipitous rise in interest rates, the labor market has proven resilient, unemployment remains at historic low levels, and wages are growing. Residential home values have held steady—lower supply offsets the impact of higher mortgage rates. With moderating inflation and sustained GDP growth despite ongoing interest rate hikes, investors have gained confidence that the economy can avoid a harsh recession. The combination of recent stock market gains and buoyant home values has increased household wealth by 43% over the past five years.[3]

Potential Headwinds

Rising interest rates have a lagging effect, which means that the full impact of the Fed's tightening campaign is still playing out, potentially pressuring consumer health and future retail sales. In fact, consumer credit balances and delinquencies are increasing. Amid inflation and general economic uncertainty consumer sentiment and the personal savings rate also have slipped to 15-year lows as excess savings built up during pandemic lock-downs are quickly being exhausted. Despite greater recent optimism and a lower likelihood of a recession, a survey of business and academic economists still pegs the probability of a recession in the next 12 months above 50%.[4] A recession would decrease consumer demand, undermining retail sales and impacting retail fundamentals if retailers retrench and pull back on store openings.

Exhibit B: Store Openings and Closures

Source: ASB Research. Statista. JLL. * Through April 2023.

[1] ASB Research. Statista. JLL.
[2] CoStar.
[3] Board of Governors of the Federal Reserve System. As of 2023Q1.
[4] Wall Street Journal surveys of economists. As of July 2023.

Retail Investment Perspectives

Retail investments feature a great diversity of sub-types, positioning and risk profiles. According to Green Street, retail cap rates for shopping center assets can range 550 basis points between grocery-anchored neighborhood centers in gateway markets on the low-end and non-grocery, power centers located in tertiary markets on the high-end.[5] This underscores the risk that retail investors must navigate when deploying capital and the need to understand tenant mix and trade area in underwriting.

Well-positioned retail investments feature a diverse mix of retailers resistant to competition from e-commerce. Grocery-anchored centers and centers with restaurants, bars and recreation/entertainment establishments can generally be expected to have more reliable customer traffic. Health/personal care stores along with building materials/garden supply (home improvement) have also demonstrated good growth with limited e-commerce penetration.

Trade areas where aggregate spending by residents significantly exceeds retail sales point to underserved markets where excess demand can confer better income-durability. Trade areas comprising a larger percentage of residential demand are likely to experience less volatility than markets driven by office workers and international tourism which can be impacted by work from home, seasonality, exchange rates and even geo-political issues.

[5] Green Street. (March 10, 2023). Strip Center Update.

ASB REAL ESTATE INVESTMENTS

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