INSIGHTS

X TEAM Retail Advisors

2024

Exploring Retail Trends
& Transformations

XTEAM
RETAIL ADVISORS

Welcome to the 2024 edition of X Team Insights. This annual publication showcases the decades of collective experience of our X Team professionals who are constantly leading within their markets, their firms and teams, and in the industry.

When we look at what X Team has accomplished in the past year, I'm struck by how much our organization has grown, adding 10 new offices nationally and expanding our unique platform. We've also formally launched X Team Retailer Services, providing a robust offering to retailers looking to expand their footprints and have a cohesive, data-driven approach that meets retailers where they are and adapts to their needs. In addition, Owen Hutchison has joined the X Team platform as our Head of Retailer Services and is your resource to be able to access the power of X Team for any of your needs.

Adaptability and perseverance have been key themes for the retail market throughout 2024. Retail took its licks early in the cycle as some brands contracted and others went away altogether. Retailers, owners, investors and developers shifted strategies. We're now facing record low vacancy as new development has crawled to a near-halt. Rising construction, material and labor costs, inflation and higher borrowing costs have all impacted the current market, leaving commercial real estate in a sense of extended malaise.

X Team Insights examines what it means to transact in 2024 and how the current market is impacting new development, retailers, investment, and consumer trends, plus where the bright spots are in cities that are reinventing themselves, and where smart players can themselves adapt.

> "Adaptability and perseverance have been key themes for the retail market throughout 2024.

DAVE CHEATHAM
PRESIDENT
X TEAM RETAIL ADVISORS

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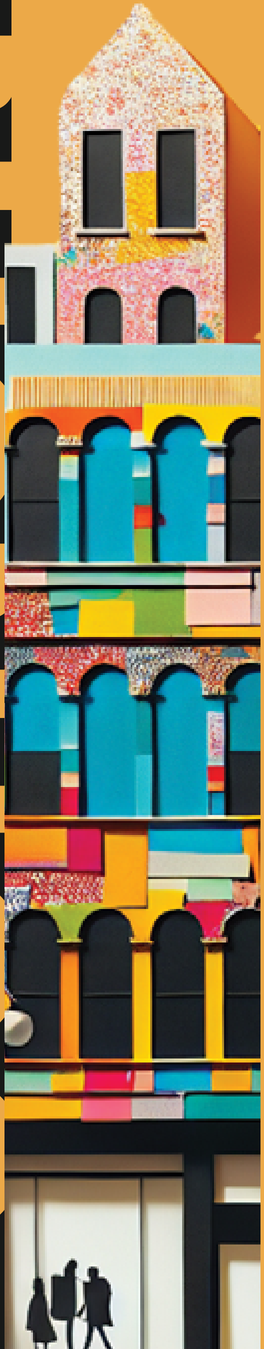


Is Retail Braced for Impact, Or Hitting the Release Valve?

By Jason Baker, *Baker Katz*

If we've learned one thing in the past few years of this cycle, economists in all their wisdom are very good about telling us where we've been, but not so good at telling us where we're going. We kicked off 2024 in a similar way that we kicked off 2023, braced for impact on an economic hard landing that so far, has yet to materialize.

As commercial real estate professionals, we must remember that when the Federal Reserve began raising interest rates in 2022, the intention was to (necessarily) cool inflation and bring down the cost of goods and services. Despite the Fed's best efforts, however, the market of 2024 is characterized by rising borrowing costs and higher prices for goods, services and labor. From a retail perspective, this has driven landlords to pause expansion and development plans, resulting led to a tighter yet lopsided market with increases in both vacancies and rental rates.

Among the retailers announcing bankruptcies this year are 99 Cents Only and EXPRESS, both of which are legacy brands that had exceptional real estate in key markets. These retailers didn't make bad real estate decisions; rather, they failed to adapt and innovate alongside competition.

While no one wants to see brands fail or contract, these bankruptcies will ultimately be good for leasing. There's a growing number of quality retailers that are meeting consumer demand in 2024 yet cannot expand due to supply constraints. Those shops will have their release valve pulled by these bankrupt retailers put good real estate back into the market.

These days, smart landlords of good real estate aren't as devastated as space givebacks, since they can—in many cases—re-lease the space at higher rates given the historic lack of inventory in the current market.

During COVID we saw 50 to 100 retailers disappear from the market altogether, while others contracted, declared bankruptcy and shifted strategies, changing the broader retail landscape. As we approach the five-year mark since the pandemic's onset, these spaces have been reimagined and backfilled, while new concepts emerged—to varying degrees of success. We're continuing to see more retailers contract, yet many more are in expansion mode.

While the market tends to think that we're over-retailed, we're not. Developers put on the brakes in the last cycle and have been thoughtful about adaptive reuse, and as this protracted period of high capital costs continues, we're seeing less and less new product available for tenants looking to expand. Owners and developers will have to pick up their shovels soon to meet the demand for spaces by late 2025 or early 2026.

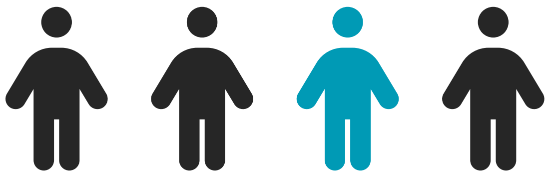
In Phoenix, for instance, retail and real estate overall was hit incredibly hard by the GFC, with the development pipeline for retail protracting to a nearly 15-year period. Sites identified long ago by big-box retailers like Target and Home Depot are just now being developed and leased up.

In traditional FIRE (finance, insurance, real estate—and in the case of Houston, oil and gas) CBD markets like Los Angeles, Houston, and even New York City, ground-floor retail in mixed-use properties has had a hard time as demographics shifted dramatically over the past four years. The popularity and convenience of remote work led to a population migration—mostly young urban professionals—to less expensive markets.

Multifamily rental rates continue to rise in double digits across the country, but formerly robust downtown cores are seeing stunted new development, while existing projects are offering rare concessions to lure in new residents. Ground floor restaurants, gyms, and coffee shops sit vacant. The mixed-use market has shifted away from downtown cores and long-term planning, toward the farther reaches of the market where land and rental rates will be lower. ■

4.6M+ **Retail establishments in the US**

55M **Total US Retail Jobs**



Retail accounts for **1 in 4 jobs** nationwide

State of Retail 2024

7% to 9% GROWTH

2024 non-store and online sales are projected to reach as much as $1.5 trillion.

45.5 MSF

Q1 2024 Retail Absorption

4.1%

Vacancy Remains at Record Lows

3.1%

YoY Increase in Asking Rents

42%

of E-commerce orders involved use of brick-and-mortar stores

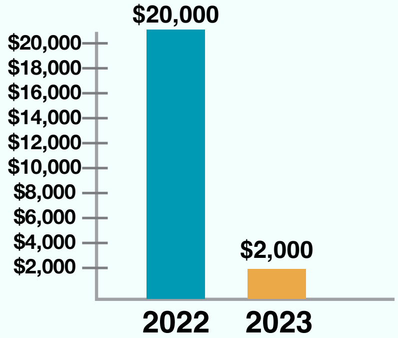
The e-commerce share of total retail sales dollars has increased at an **average annual rate of 7.34% since 1995.**

86%

of net Q1 absorption was by General Retail and Neighborhood Centers.

Shipping Costs Have Declined

The price to ship a 40-foot container from Shanghai to Los Angeles/Long Beach has declined by $18K in a year.



Consumers are maintaining a healthy spending trend.

Retail sales will grow as much as 3.5% this year to $5.28 trillion.

Consumers Remain Tethered to Debt

$17.5 Trillion

Total Household Debt at Year-End 2023

$3.4 Trillion

Balances have increased by $3.4 trillion since 2019.

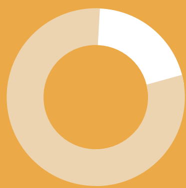
$120 Billion

Consumers are on pace to add as much as $120 billion to outstanding credit card balances this year, potentially setting a new record.

$5.3 T

ANNUAL CONTRIBUTION

Retail is an important component of the US Economy



20% GDP

Sources: Capital One Shopping, Federal Reserve Bank of New York, Federal Reserve Bank of St. Louis, ICSC, National Association of Realtors, National Retail Federation, U.S. Bureau of Labor Statistics; U.S. Census Bureau, U.S. Small Business Administration, WalletHub

Downtowns, Redefined

Toro Development's Medley, a 43-acre project in the Atlanta suburb of Johns Creek, has leased more than half of its 180,000-sf phase-one retail space months before even breaking ground.

The overarching trends in today's market provide clear evidence that retail is not just evolving, but thriving as it proves its resilience. What's interesting about this post-pandemic period, however, is the way in which broader migration and economic trends are effectively redrawing the population centers of the US. The result is redefining how we classify markets and real estate.

The fabric of the nation's urban centers is changing as retailers follow shifting population and migration trends. The result may require revisiting how we classify markets and real estate.

By Darren Wood & Lauren Faulkenberry
The Providence Group

Core Downtown Doldrums Won't Go Away Easily

The growing sentiment is traditional downtowns are dead, dying or on life support across the U.S. and elsewhere. Certainly, there are facts to support that notion. Major cities have been losing people. For example, NYC's urban core lost 5% of its population from 2020 to 2022, while San Francisco's lost 7%. Foot traffic near stores in metro areas remains 10% to 20% below pre-pandemic levels.

The percentage of people working from home is now four times what it was 2019, reducing economic power of traditional CBDs. Demand for office and retail space in superstar cities is expected to remain below pre-pandemic levels as more people spend time at or close to home—which usually means the suburbs.

Another point working against retail in many traditional CBDs is the quality of the inventory. Mass announcements of retail bankruptcies curbed new development in the sector, while many centers have closed or been redeveloped. Retail space is already scarce—CoStar reports it's at a multi-year low—and the pickings are even slimmer in core urban markets. Many downtown retail properties haven't been revamped in years aren't necessarily what today's retailers and food-and-beverage tenants are seeking in terms of store size and characteristics.

The migration patterns of Millennials also have significant implications for real estate and the retail sector, influencing consumer behavior, market demand, and the geographical distribution of retail establishments. Millennials are moving from major cities to the suburbs en masse; small and midsize cities that have seen a similar boom in newcomers are now adjusting to a new normal.

Over the past four years, the Sun Belt has experienced population growth that's bringing new opportunities for retailers. As of 2022, the region housed 12 of the 15 fastest-growing cities. According to Census data, from April 2020 through July of last year, the South's population grew by 3.9 million people, with Florida, Georgia, and Texas experiencing some of the largest population spikes. That significant growth has created such intense demand for retail real estate that the industry is having a hard time keeping up with.

The result of all those factors is forcing local governments and urban residents to consider what the post-pandemic city will look like. Downtowns filled with acres of banal office blocks, with accompanying ground-level retail stores and shopping malls, are becoming a relic of the 20th century. In trying to ascertain what to build in their stead–that is, what people want and need—requires cooperation from all segments of a community. Some communities may focus on housing, while others opt for more recreational opportunities—or a combination of several uses.

Smaller Cities' Urban Renewal Moment

Migration trends have led to new communities emerging, as well as the revival of existing ones. Business owners in the market for retail space today are generally attracted to either urban-type districts with an authentic feel or master-planned developments with a captive population. That's created an environment where retail real estate is undersupplied in key markets, including high-end suburbs retailers increasingly are targeting.

In today's busy world, the appeal of convenience is driving increased demand for placemaking. The pandemic experience showed us that walkable proximity is more desirable than ever. As remote work became increasingly common, the surrounding context took on a new importance and retail thrived in walkable neighborhoods. This has translated into continued appeal for suburban lifestyle or power centers, which are compelling draws for both local, independent small businesses as well as national chains.

It's easy to see why retail centers with major draws like grocery anchors are projected to continue performing well since they serve as a one-stop shop. On a larger scale, urban cores could experience revitalization in many of the country's second- and third-tier cities. These cities desire to convince potential transplants that they can have it all—namely, that they can find big-city amenities in smaller places like Charlotte, Denver, Minneapolis, Salt Lake City, Dallas or Louisville. Often, however, they

In the North Platinum Corridor of Frisco, TX, The Mix is a $3-billion progressive "mixed-experience" community built around a vibrant central park. The 28-acre project will have 375,000 square feet of retail, including a grocery store, as well as a hotels, office and residential space.

Nashville Yards is Southwest Value Partners' $1-billion project on a former railyard site in downtown Nashville's western edge. The 18-acre development will include 400,000 sf of retail and entertainment space, as well as office, residential, hotel components and a public park.

must also fight against the perception that they've essentially created virtual replicas of each other, with highly curated, homogenous, controlled environments.

Redefining the Playbook: Boomtowns on a Budget

The new playbook for projects in up-and-coming metros is anchored on engineering a site to produce the kind of amenities that middle- and high-income workers have come to expect from an urban neighborhood—walkable downtowns, diverse restaurants, craft-brew pubs—at a fraction of the price. A lot of the migration, after all, was driven by rising cost of living in the first place.

Affordable areas near major, higher-priced metros have been migration hotspots, but even those areas are getting more expensive. According to a 2023 analysis of walkable urbanism, homebuyers in the 35 largest U.S. metro areas paid 34% more to live in walkable neighborhoods, while renters paid 41% more.

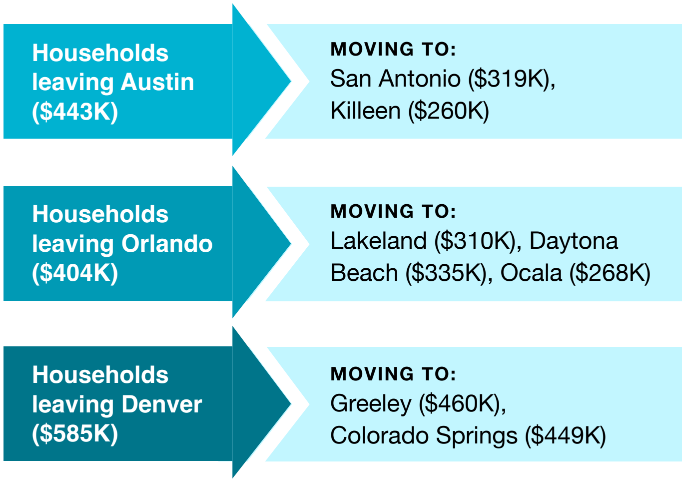
As high-growth markets have become increasingly expensive to buy and rent homes, many potential homebuyers have been forced to relocate to nearby, smaller markets with more affordable homes. A look at domestic migration patterns over the past few years highlights this trend, as once-popular markets for relocations are starting to bleed residents choosing to move to more affordable infill areas.

Even without the empirical evidence in countless reports, it's clear that massive shift is occurring in favor of secondary and tertiary cities. One need only look at the development activity in markets like Dallas-Ft. Worth, Austin and Houston in Texas (which topped population growth for three years running), where developers are trying to keep up with the influx of housing and retail demand. The story is the same in places like Charlotte and Raleigh, NC; Nashville, TN; Atlanta, GA; and even Florida locales like Tampa, Jacksonville and Lakeland.

These cities and others are seeing a rise not just in development, but a growing reliance on placemaking. Retail and F&B companies are increasingly being drawn to suburban open-air lifestyle centers in the suburbs or in up-and-coming quasi-urban neighborhoods that are near to, but not necessarily in, major city cores. Many areas have emerged as the suburban retail districts in their respective metros, encompassing trendy neighborhoods and town village-style, open-air concepts.

These large-scale, mixed-use projects blend much-needed housing, retail and additional amenities in a carefully constructed environment meant to evoke a sense of community, relevance and belonging. If leasing interest and activity are any indication, retailers looking to benefit from these built-up population centers are chomping at the bit to land space within these projects, as well as in neighborhood centers nearby.

2024 Migration Hot Spots Are Smaller, Affordable Metros Near High-Priced Markets



Whether they're in traditional downtowns or in newer suburban locales, the "urban" centers emerging now and in the coming years won't center around a strictly office or retail nucleus. Rather, they'll anchor around entertainment and lifestyle offerings, with complementary retail elements serving an accompanying, or nearby, housing component.

As the fabric of the country's urban centers continues to evolve, savvy retailers will adjust meet shifting consumer demand. Those who adapt are likely the ones we see emerging from the upheaval with retail offerings and innovative concepts that thrive in today's redefined environment.

Charlotte: A Case for Walkability

A recent study by analysts from Nuveen found that Charlotte was among the cities best positioned to benefit from global megatrends. The Queen City is emerging as a banking powerhouse, home to more than 53,000 finance jobs, ranking fifth on an absolute basis and first when adjusted for the size of the local labor force. It also placed first among extra-large metros (populations of 2.5 million+) in the latest Best Places to Live in the U.S. in 2023–24.

The Charlotte Metro has grown 18% in the past decade, adding 424,000 new residents. The resiliency of the local economy is evident in the fact that it produced 7.5% more jobs than prior to the pandemic, versus 3.3% for the U.S. overall. Only six U.S. markets with employment bases greater than 1 million have had a stronger recovery.

Charlotte's growth has led to a redefinition of the city's submarkets outside of Uptown, the traditional central core. The city is becoming more walkable as the adaptive reuse of districts advances and more models of high-quality destinations emerge. This includes the reimagining of a variety of retail concepts, often anchored on designs for public spaces that include a wide array of uses.

As Charlotte blurs the lines between public and private spaces, multiple- and simultaneous-use spaces can be created, extending the use case of that space. The incorporation of cultural and lifestyle elements goes even further to create connection and engagement in these spaces.

One of the biggest standouts is Charlotte's South End, which has experienced tremendous growth over the past decade. Formerly dotted by warehouses serving the city's mill industry, the area became popular with art galleries and designers after manufacturing's departure.

A number of projects have transformed Charlotte's infill areas into vibrant neighborhoods, particularly the South End. Projects fueling growth include Asana's historic Design Center (left), a hub for 2,000+ daily users of the Rail Trail, and Edens' Atherton Mill (below), one of the top destinations in the South End.

Growth went into hyperdrive upon the 2007 launch of the light rail, turning the square-mile South End into one of the country's fastest-growing apartment submarkets—with retail to support that growth. Today, the thriving district combines Southern hospitality with commerce, resulting in a mix of hip breweries, eateries, and event venues with local businesses, retailers, and *Fortune* 500 companies.

A key catalyst for the emergence of such districts is often the vision of developers seeking to transform an area. That has been the case for Edens' Atherton Mill, which the national retail developer envisioned as a new center of gravity for the South End. Built as Charlotte's first factory in 1920, Edens' 2019 redevelopment brought in nationally recognized brands alongside local businesses and unique drinking and dining options, complemented by a full calendar of events and experiences. Located on Charlotte's Rail Trail, Atherton is now one of the city's top destinations, serving as the "Soul of South End."

Another project fueling the South End's growth is Asana's historic Design Center. Marked by a landmark water tower, the project serves as a hub for more than 2,000 daily users of the 3.5-mile pedestrian Rail Trail that connects residents and visitors alike to highly trafficked areas along its path.

Not far from the South End is Midtown, another growing Charlotte submarket a mile outside of the city center. Among the transformative projects there is Northwood Investors' Metropolitan. A recent refresh and remerchandising plan brought an array of new names to the area.

Part of the remerchandising included activating the once-ignored greenway-facing side of the property, branded as Midtown Row. The latest restaurant concept to arrive at Metropolitan is chef Greg Collier's 3rd & Fernwood, along with Lost Worlds Brewery, Joan's Bakery & Deli and a pop-up by the Accidental Baker. These complementary concepts not only serve the residents living in Midtown, but the Metropolitan's strategic position also helps to draw visitors to Midtown via the greenway and other nearby access points. The property, which anchored by a Trader Joe's and includes Best Buy and Marshalls, includes a 1.3-acre lot slated for roughly 280 multifamily homes.

Retail's Great Space Race

Increased competition and a scarcity of space has expanding brands going head-to-head for growth opportunities.

By Dave Cheatham & Darren Pitts
Velocity Retail

There's little question that the US retail industry is undergoing yet another evolution as consumers and businesses alike get used to the economic new normal. The past few years saw dozens of retail bankruptcies and thousands of store closures as companies dealt with unsustainable or outdated business models. Interestingly, the retail sector as a whole didn't falter, and retail real state is potentially the healthiest it's been in recent memory. And if anecdotal evidence and empirical data are any indication, these conditions are expected continue for quite some time.

Last year marked the second time store openings outpaced closures, with 4,913 locations shuttering and 5,645 stores making their debuts, according to Coresight Research. Still, the closures marked an 80% increase over 2022, driven by a large amount of big box shutdowns—particularly Bed Bath & Beyond, which closed nearly 900 locations.

Through the first four months of this year, retailers have announced about 2,600 closures, a 2.5% uptick, compared to 3,560 new stores. Many of those involve brands that have been longtime underperformers, like long-suffering clothing store Rue21, which announced bankruptcy. Some were victims of circumstance and competition; drugstores like Walgreens, CVS and the bankrupt Rite-Aid cited rising drug prices, lower staffing levels, and opioid lawsuits among the reasons behind their decision to shutter hundreds of stores. Other closures are strategic moves in the wake of major business decisions, like the Target and Walmart stores closing due to rising theft or Dollar Tree shedding 1,000 stores in the wake of its acquisition of Family Dollar.

At the same time, many retailers—including the ones behind some of the announced closures—are adding locations, often in new markets and new formats, or revamping existing stores. Macy's is closing 150 stores but plans to open to 30 new small-format stores by next fall. And dollar stores offset their closures with announcements of 1,600 new stores in 2023, and another 1,500 targeted for 2024.

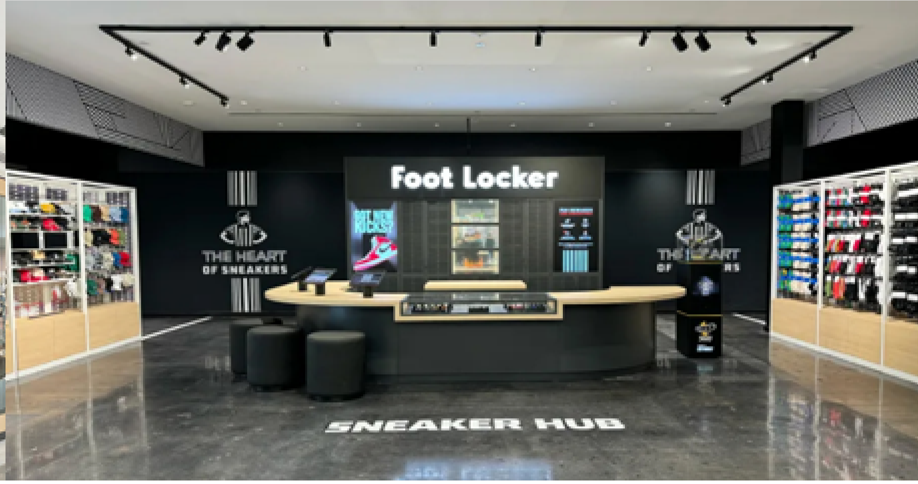
The Dichotomy in the Data

To better understand the current dynamics of the retail market, it's helpful to take a look at the performance data. For the 12 months ending in March 2024, the national retail market recorded 52.3 million sf of absorption, outpacing 50 million sf of deliveries, as per CoStar, keeping vacancy at a record-low 4.1%.

These positive results in the face of massive shutdowns can largely be attributed to supply-demand fundamentals. The amount of dedicated retail space in the U.S. has declined significantly over the past 15 years, hitting a multi-decade low of 54.3 sf per capita, CoStar found. The past five years have seen over 145 million sf of retail space taken off the market due to demolishment or conversions to multifamily and other uses. Developer restraint is keeping deliveries at a fraction of historic norms, and the space that is coming online is often built to suit or quickly filled up; 70% of the 51-plus million sf under construction was preleased, as per CoStar.

Not surprisingly, fundamentals are strongest in the sectors with the most consumer demand and markets that have seen greatest population gains. Sunbelt markets have seen the greatest activity—NAR reported that the three Texas markets of DFW, Houston and Austin collectively absorbed over 8.5 million sf of retail space YoY

IKEA and Macy's are among a growing cadre of chains that are experimenting with reduced footprints while relying on improved customer service and digital integration. In many cases, these miniature offerings are meant to complement, rather than replace, the brands' larger stores.



in Q1, taking up the top 3 spots for absorption nationally. And consumers' search for value is helping dollar stores, warehouse clubs, and off-price and discount retailers, which collectively announced 2,170 new stores last year, accounting for 35% of all stated openings.

Retailers trying to operate in this environment of scarcity are having a tough time securing locations, especially in the store size and submarkets they're targeting. Simply put, there just isn't enough good space to go around. As a result, retailers are continuously innovating to meet consumer needs while making the most of their space.

Stores are Getting Smarter with Space

As retailers embrace multichannel approaches, they're increasingly melding their online offerings with their physical retail. Major chains like Walmart and Target are using their massive store footprints to aid in online fulfillment, reducing the need for warehouse space and improving delivery times and customer satisfaction. DTC and digitally native companies like Revolve, Glossier and Wayfair are opening their first brick-and-mortar locations, and more brands are expected to follow.

One of the most striking shifts in retail leasing is the preference toward smaller store sizes. For instance, openings outpaced closings last year by over 700 stores over the past year, but in terms of inventory, closings surpassed openings by 10 million sf. In fact, CoStar reported the average US store size at 3,200 sf, the smallest it's been since the firm started tracking the data in 2006.

Retail absorption outpaced deliveries by 2.3MSF

It's true that F&B retailers, which typically aim for stores under 5,000 sf, have been on a tear in recent years, but they only accounted for 20% of last year's leasing activity. The other major change is the growing popularity of smaller-format stores, which allow brands to have a presence in markets that wouldn't support a large footprint, while reducing inventory to select items curated for the neighborhood's demographics. Not the mention the added benefit of cost savings from lower rents and reduced overhead.

In addition to Macy's, Nordstrom, Best Buy, Target, Kohl's, The Container Store, and Ikea are among a growing cadre of chains experimenting with reduced footprints while relying on improved customer service and digital integration. In many cases, these miniature offerings are meant to complement, rather than replace, the brands' larger format locations. One of Ikea's newly opened "Plan-and-Order-Points" in Metro DC, for instance, is 8,000 sf, or just 2% the size of the traditional Ikea warehouse, a 371,000-sf store located 40 minutes away. It carries the retailer's most

Retailers are exiting locations that have become less popular with shoppers in favor of sites closer to population centers. Foot Locker announced that it was closing 545 of its mall locations by 2026, while opening 300 non-mall shops.

popular products but relies more heavily on online orders and in-house design experts that can assist customers with planning and products.

Retailers are also exiting locations that have become less popular with shoppers in favor of sites closer to evolving population centers, a trend reflected in recent reports. According to Coresight, off-mall retailers comprised 83% of store openings in 2023. Similarly, NAR notes that general retail spaces and neighborhood centers accounted for about 86% of annual net absorption as of March 2024.

Journeys, Gap, Bath & Body Works and Foot Locker have joined the bevy of tenants eschewing their traditional mall digs to open locations in shopping centers. B&BW closed 50 mall stores last year and opened 90 standalone locations. More recently, Foot Locker announced that it was closing 545 of its mall locations by 2026, while opening 300 non-mall shops. Part of its “Lace Up” growth plan, the new store formats focus on storytelling and “supporting sneaker culture,” according to the company.

Development Plays Catch-Up to Demand

A recent study by UBS estimates that the US may lose almost 50,000 retail stores by 2028 as retailers reexamine store performance and location data and e-commerce takes a greater share of sales. Yet the firm points out that many of those closures are in properties like underperforming malls. At the same time, competition is high in growth markets, which are already suffering from a lack of retail to serve the burgeoning local populations.

Like a reverse “If you build it, they will come” scenario, developers must play catch up to demand and consumer trends. The retail landscape is poised for further transformation, with opportunities for those who can innovate and align with changing market dynamics. ■

DTC and digitally native companies like Wayfair are opening brick-and-mortar locations, and more brands are expected to follow. The home goods retailer’s first store is opening in Illinois in May 2024.

5 Predictions for the Capital Markets

By Joe Caputo, *Secure Net Lease*

When the Federal Reserve started raising the overnight rate in March of 2022, no one knew what was ahead. Eleven rate hikes later, inflation remains high and commercial real estate investors (and brokers) are losing their optimism. In the information age, we thought that we had the interest rate game down to a science, but Chairman Powell and high inflation have kept commercial real estate on its toes. Experience and market intelligence, however, tell us that there are green shoots ahead.

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1 Interest rates will go down…eventually

2024 started off optimistically, with conventional wisdom allowing most of us to think that the Fed would lower rates in January and then pause prior to the election. Obviously, no such announcement came, and the protracted high-rate environment continues. Nothing lasts forever, though. Interest rates will eventually come down, likely at least one rate cut before the November federal election.

2 The Bid/Ask Spread is Tightening

The rapid jump in rates created whiplash among buyers and sellers, deepening the chasm in the bid/ask spread. As the cycle has progressed, there some price discovery appears to be surfacing. Sellers are making less money per transaction in 2024, but there are more transactions taking place. Sellers are becoming more educated on where they need to be in order to transact.

3 Can’t Play the Waiting Game

Buyers and sellers alike have learned that they can’t stay on the sidelines for an extended period of time. There are still good investments to be made. As more players work around the mind games necessary to move ahead and start transacting, investment activit will return to typical levels.

4 Tenants Must Catch Up to the Capital Markets

Higher rates caused a massive pause in activity across all facets of the economy as many businesses were reluctant to make major decisions. Yet some retail tenants are now meeting the market where they need to be, moving up the yield-to-cost level. Others are slower to make changes in policy to meet the market and current rates due to capital costs. Call it analysis paralysis or simply being conservative—being slow to conform means missing out on opportunities.

5 How Much Longer Will This Last?

The crystal ball, however foggy, suggests that we’ll have one rate decrease before the end of the year, likely before the election, and potentially two before the end of the year. With the lack of the inventory in the pipeline due to low construction, coupled with the seasonal uptick in transaction closings in December, we could see the stars aligning for retail investment sales to really pick up at the end of 2024, creating a micro bull-run, particularly for triple-net investments.

Inflation Pains, Grocery Gains

By Lea Clay Park, *Axiom Retail Advisors*

It's no secret that inflaton has been wreaking havoc on American consumers, and grocery prices have been one of the hardest-hit segments of retail. The cost of groceries has increased by nearly 25% in the past four years, according to the U.S. Bureau of Labor and Statistics. Further, Nielsen IQ reports that with the average unit price of consumer-packaged goods (CPG) increasing by 4% to 8% in 2023, consumers are increasingly shifting their habits to stretch dollars.

According to Groundwork Collaborative's report from February 2024, American families are now paying 25% more for groceries than they were prior to the pandemic, compared with 19% overall inflation.

In examining the issue, the study alludes to potential corporate profiteering, as well as climate change and global conflicts, as factors in rising costs.

Skyrocketing grocery prices—and retailers' rising revenues—even prompted the FTC to investigate the issue. The agency blamed three major retailers—Kroger, Walmart, and Amazon—for exacerbating supply chain disruptions during the pandemic, leading to inflated grocery prices and product shortages.

Unsurprisingly, the agency also turned its eyes on the potential merger of Kroger and Albertson's. The $24.6-billion deal would create a grocery powerhouse capable of competing with giants

Making a push into urban locations, Wegmans opened its first Manhattan, NY store in 2023 to much fanfare. The two-story supermarket in Astor Place has almost an entire floor dedicated to a food court.

Consumers' shopping habits are evolving in response to inflationary pressures. The move hasn't gone unnoticed by grocery retailers, which are adapting their strategies to emphasize value, convenience and accessibility to maintain a competitive edge.

like Walmart and Amazon—creating a ripple effect impacting everything from supply chains to M&A activity across the grocery space. The FTC blocked the deal, citing antitrust laws and concerns that the merger would significantly reduce competition within the grocery industry, leading to higher food prices, reduced quality, and diminished bargaining power for union workers. As of this writing, the companies have been making efforts to make the deal more palatable to opponents.

Shifting Shopping Habits Offer Expansion Opportunities

Despite economic challenges, low unemployment and stable household spending indicate resilient consumer sentiment. A closer look at where and how that spending is occurring, however, reveals that priorities are shifting as consumers change their shopping habits in response to inflationary pressures. Whereas they once looked for one-stop-shopping options, they're now making trips to multiple retailers in search of values—even traveling to stores in cheaper zip codes, buying in bulk and pursuing loyalty programs for the savings. Data firm Numerator found that Americans bought groceries from an average 20.7 different retailers between March 2023 and February 2024. Additionally, value-priced grocers were the only tier whose share of sales grew last year (0.6%, as per Nielsen IQ).

Given the conditions, it's no surprise that discount grocers are in rapid expansion mode. Dollar General, Dollar Tree, Aldi, and Lidl collectively expanded their store footprint by almost 17% from 2019 to 2023. Coresight projects dollar and discount stores, which brought in about $76.5 billion in revenue 2022, will grow by at least 27% by 2027.

Leading the pack is Aldi, which opened 109 new locations totaling 2.5 million square feet in 2023, a 32.3% increase from 2022. The chain, which currently counts over 2,300 locations, will invest more than $9 billion over next five years on a national expansion that will create 800 new stores.

As Aldi doubles down on its reputation for low prices, other grocers are stepping up their efforts to highlight a commitment to value. Publix and Grocery Outlet respectively opened 38 and 29 new stores last year. Sprouts debuted 30 locations in its the new cost-effective model of smaller and more efficient stores, with another 300 or so potential sites earmarked in expansion markets. Whole Foods and Trader Joe's are doing the same in markets that won't support a full-size store, as in dense, urban locations.

Dollar stores, still riding high on the wave they caught last year, are seeking ways to capitalize on the opportunity to become affordable grocery destinations. Dollar General opened

987 new locations and executed 2,007 remodels last year, with plans for another 800 stores in 2024. The chain, which opened its 20,000th store in March, sells fresh fruits and vegetables at more than a quarter of its locations and is targeting up to 1,500 additional stores for produce in 2024. And although it's closing hundreds of Family Dollar stores, Dollar Tree added over 1,500 locations between 2019 and 2023. The chain gained 3.4 million shoppers in 2023, a large portion of which consisted of households earning more than $125,000 a year.

Private Labels, Foodservice Grow as Shoppers Seek Value, Convenience

Customers haven't only changed where they're shopping, but also the brands they're buying—or to be more precise, the lack of a brand. According to Nielsen IQ, sales of private-label (aka store brand or "no name") products grew 5% year-over-year, accounting for 19.4% of all grocery dollars and outpacing national CPG brands, which are seeing an erosion in their sales. And PLMA's 2024 Private Label Report, conducted by Circana, found private labels rose 4.7% in 2023 to a record $236.3 million. Store brands accounted for nearly 25.5% and 18.9% of all F&B sales by number of units and dollar sales, respectively. For core pantry items, private labels took 26.6% of all dollars spent.

The shift hasn't gone unnoticed by grocers; several are investing in growing their cache of private-label products. Aldi's success is partly attributed to its own brands, which account for nearly 78% of the retailer's overall sales. Both Dollar Tree and Dollar General intend to expand their in-house selections, and Costco's fan-favorite Kirkland Signature label now accounts for 28% of the retailer's total sales. Not to be outdone, Walmart just launched Bettergoods, the chain's biggest proprietary food brand in 20 years with some 300 products, positioning itself in direct competition with Trader Joe's and Aldi's.

Rising prices at restaurants and casual dining establishments have also opened the opportunity for grocers to get into foodservice—one of the fastest growing and most profitable segments for supermarkets. Foodservice is getting a starting role in retailers' floor plans and merchandising strategies as they seek to attract consumers looking for quick meals, including lunch options for those working from home.

Long known for its prepared foods, Wegmans has an executive chef heading up the culinary staff at each of its stores. Nearly an entire floor of its newly opened two-level Manhattan store is dedicated to foodservice. Supermarkets including Hy-Vee and Walmart feature food halls at some of their locations, and

Discount grocers are in rapid expansion mode. Dollar General, Dollar Tree, Aldi, and Lidl collectively expanded their store footprints by almost 17% from 2019 to 2023.

Northgate Market's new Mercado concept features food vendors serving authentic Mexican cuisine. Other retailers like H-E-B, Giant Food, ShopRite, Publix and Save Mart brands are expanding their prepared food offerings, forming partnerships with local restaurants, or both.

The crux for these grocery brands is to find ways to deliver these features without breaking the bank—or consumers' wallets. Services that require large investments or heavy staffing must be able to clear their overhead. For example, when newly merged Chicago-area grocers Foxtrot and Dom's Kitchen & Market announced they were ceasing operations across their nearly 40 stores, it sent shockwaves through the industry as well as the communities the stores served. Both stores were known for imaginative formats, experiential environment and foodservice offerings. While no clear reason was given for the closures, many analysts say the stores' concepts—given their high need for staff and limited, high-end offerings—weren't sustainable once the two chains merged.

Role of eCommerce is Also Evolving

Overall value might be top-of-mind for today's budget-conscious consumers, but that doesn't mean they've forgotten about the convenient perks that grew in popularity during the pandemic. Whereas many predicted a return to the stores once restrictions were lifted, the US online grocery market continues to grow in terms of both pickup and delivery. In fact, eGrocery sales are 20% higher than four years ago, ending 2023 with $95.8 billion in total sales, according to a report by Brick Meets Click and Marcatus. Online grocery sales totaled $8.5 billion in April 2024 alone, up 4% from a year ago.

Online sales, which accounted for 12.5% of the $885 billion in total grocery spending last year, are predicted to grow three times faster than in-store sales over next five years, hitting $120 billion by 2028. Competition will only increase as more supermarkets enter the game and others boost their capabilities—and that's not even counting the third-party services that are dominating the market.

Third-party delivery services that have added grocery delivery after initially focusing on restaurants—including DoorDash, GrubHub, Uber, and even Gopuff—continue to ramp up their competitive edge. InstaCart remains the category leader, however, with more than $30.3 billion in gross transactions and $2.2 billion in revenue for 2023, a 20% annual increase. Looking to position itself as an easy and affordable way for grocers to roll out e-commerce, the company has been partnering with even more local and regional grocers.

As counterparts work out kinks in their delivery platforms, Instacart is investing the next level of its service—such

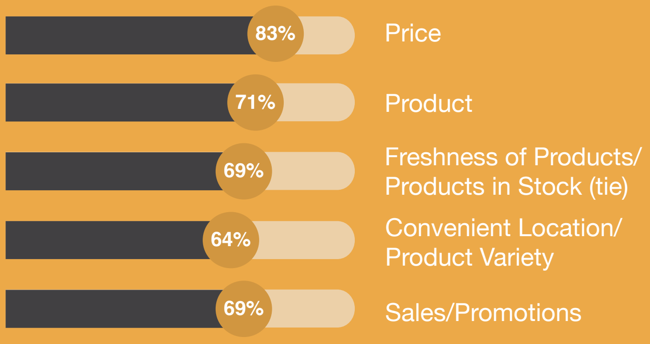
Whole Foods is opening a series of small-format grocery stores, like this one in New Yorl City's Chelsea neighborhood, offering essentials and grab-and-go options. The smaller footprints allow the retailers to go into markets that won't support a full-size store.

as new technologies like Caper Carts, shopping carts that can recognize and weigh products, help shoppers navigate the store and order made-to-order items. The AI-powered smart carts also feature personalized ads by brands that can target customers with in-store promotions. They are already being utilized in stores like Kroger, Shop Rite, Bristol Farms, Fairway, Hy-Vee, Geissler's, Schnucks, ShopRite, and other retailers signed up with Instacart.

AmazonFresh has also started to offer its own Dash Carts to third-party grocers, expanding beyond their Whole Foods and Amazon grocery banners. And in a move to rightsize its grocery ecommerce business, Amazon unveiled a grocery subscription for Prime members and EBT SNAP recipients across Amazon Fresh, Whole Foods and partner grocers such as Cardenas Markets and Save Mart.

Meanwhile, grocery retailers are expected to focus on first-party online services to control operating expenses and enhance customer experience. Noting that

Top 5 Factors in Consumers' Grocery Shopping Decisions



Source: Progressive Grocer's 75th Consumer Expenditures Study customers who shop both in-store and online spend 3-4x more than in-store only shoppers, Kroger is investing in cross-channel experiences and a slew of initiatives, such as drive-thru lanes and lockers for pickups, and AI-enabled store routing technology to help improve order fulfillment.

Walmart is tapping into its extensive store fleet to help fulfill online orders, with delivery as a particular bright spot. The move helped the retail giant lower last-mile store-to-home delivery costs by about 40% in the past year and shortened same-day delivery times from around 90% of its stores. Walmart's Q4 US e-commerce growth of 17% reflects a double-digit increase in store-fulfilled pickup and delivery, with the latter enjoying 50% growth during the quarter. The retailer also expanded its on-demand/express delivery options and plans to increase drone delivery to up to 1.8 million additional households.

Consumers Prioritize Expenses Over Experience

The next era for grocery retailers is one in which supermarket brands will further embrace technology to connect with consumers, melding physical and digital shopping into a seamless experience. Eyeing the "Next Big Thing," experts say retail media is gaining steam—*Insider Intelligence* expects omnichannel retail media ad spend to reach $59.98 billion by the end of 2024.

Consumers can expect to see more digital screens, interactive kiosks and in-store app capabilities as part of an effort to further tie together the in-store experience with retail media's reach. National and regional grocers are growing or looking into ways to benefit from retail media, encompassing everything from ads and offers played on AI-powered shopping carts, social media campaigns, to shoppable videos on store websites and customized apps offering exclusive discounts and loyalty programs. ■

Retailers are giving foodservice a starting role in their offerings to attract busy consumers looking for quick meals. Many Hy-Vee locations (top) offer food halls featuring a variety of options including a full bars and fast-casual from sandwiches to sushi. Most H-E-B stores (middle) host a True Texas BBQ or True Texas Tacos onsite, highlighting their "fresh bites" concept, and Northgate Market's new Mercado Gonzalez concept (bottom) in California features food vendor stalls serving authentic Mexican cuisine.

National Scope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