US Retail Market Thwarted by Its Own Success

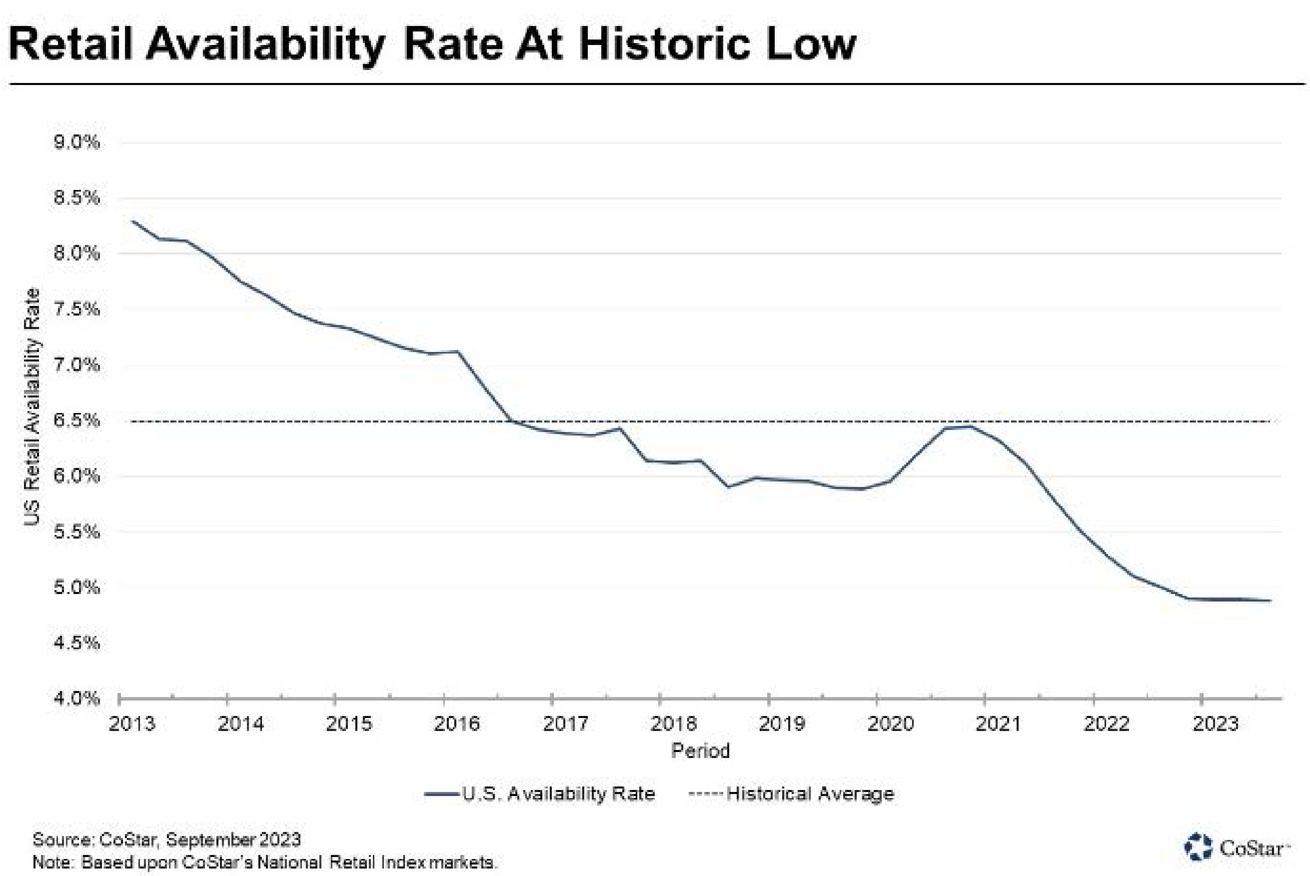
Retail Leasing Downshifts As Space Becomes More Limited in Desirable Locations

By Brandon Svec

Retail tenants across the U.S. leased just under 59 million square feet during the second quarter, the lowest amount of total space signed in a quarter in over two years.

And while the total amount of space leased is expected to rise as more leases that were signed near the end of the quarter are fully captured, leasing has certainly downshifted across retail property in the past few quarters. Trailing four-quarter leasing is at its lowest since the depths of the pandemic and about 20% below average annual leasing totals during the five years preceding the pandemic.

While concerns over the trajectory of the economy and higher tenant operating and occupancy costs are certainly factors in the leasing slowdown, so too is a lack of available space in primary corridors. Ten consecutive quarters of positive demand gains and limited new deliveries have pushed the U.S. retail market to its tightest position in nearly two decades. There is less available retail space being marketed for lease now than at any time since CoStar started tracking the retail market at a national level in 2006.

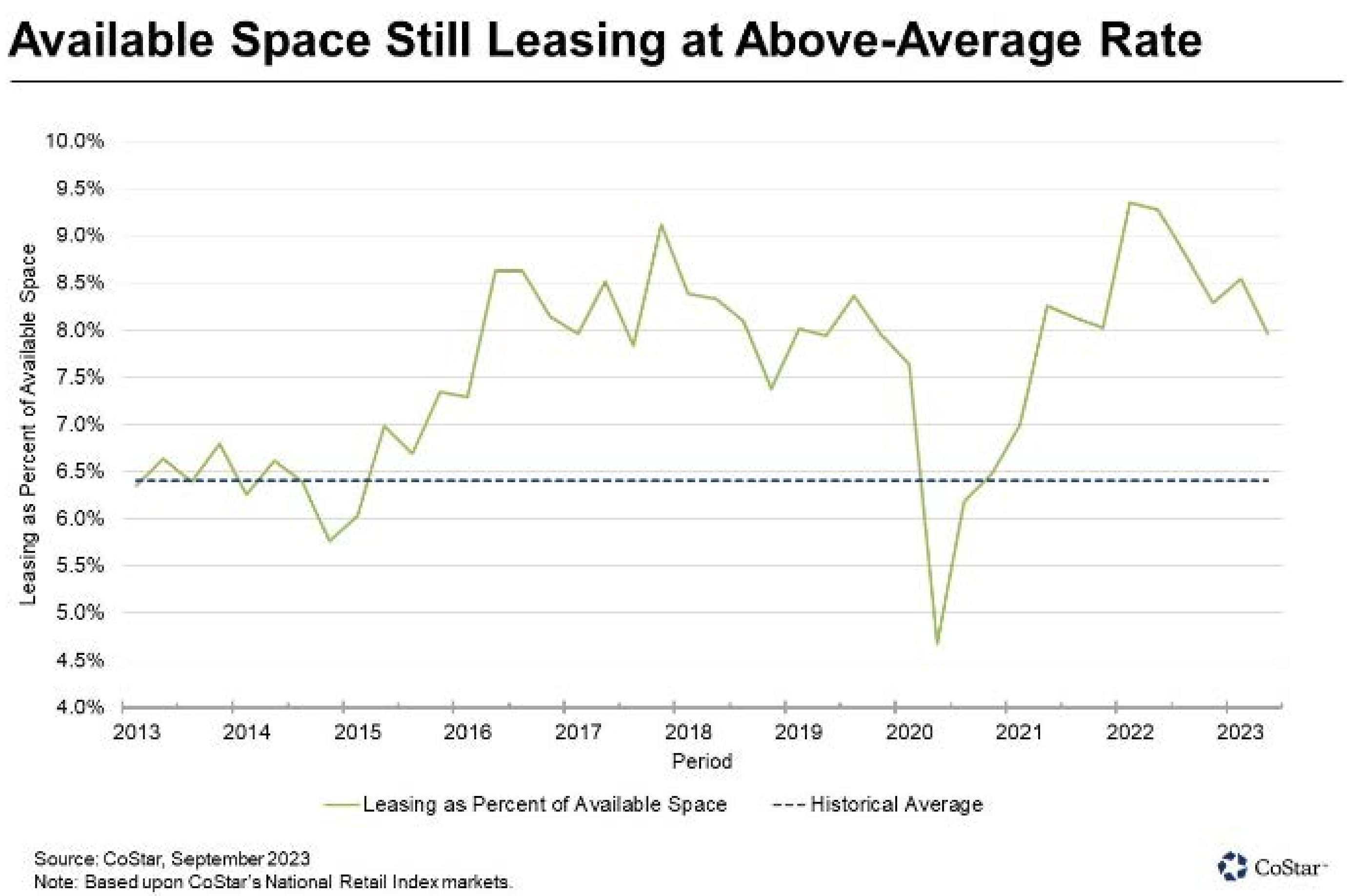


Overall, just 4.9% of total retail space is available for lease as of September, a more than 150 basis point decline from both the pandemic-era peak and prior 10-year average for retail availability, both of which stand at 6.5%. According to numerous market participants involved in representing retail tenants, the lack of desirable available space is weighing on tenant expansions, especially in fast-growing Sun Belt markets.

On the landlord side, operators of institutional-quality retail properties are feeling much more confident in the strength of market fundamentals, reporting minimal anchor availability and becoming more selective in terms of the tenants they sign for shop space.

Despite these headwinds, the share of retail space leased relative to what is available is holding near 8%, a level that remains meaningfully above the historical average. This points to still strong demand from tenants for retail space, and also some willingness on the part of tenants to accept store sizes or locations outside their targeted ranges.

For example, discount retailer Five Below, in an effort to meet aggressive store expansion goals, has reportedly been looking at potential store sites that deviate by as much as 20% from its prototypical 10,000-square-foot store in response to limited space options in high-growth markets.



While lower levels of leasing activity are never welcome, it appears U.S. retail space markets are a victim of their own success and the current latent demand serves as a positive for the long-term prospects of the sector, especially against the backdrop of record-low retail construction starts in the first half of this year.

With little new supply on the way and retail tenants left to compete over dwindling space options, landlords are likely to retain above-average pricing power, especially in primary locations, for the foreseeable future.