

US Retail Leasing Market Remains on a Roll, but Can It Last? Retailers Face Threats From Higher Costs, Lower Consumer Spending

By Brandon Svec

Retail tenants continued expanding in the third quarter by leasing just over 53 million square feet of store space and remaining resilient in the face of growing concerns surrounding the trajectory of the U.S. economy.

The total amount leased is expected to increase as deals completed near the end of the quarter are recorded. Once those deals are added, the third-quarter total is estimated to reach 68 million square feet, putting the U.S. retail market on pace for its best year for leasing activity since 2018.

Leasing activity during the third quarter continued to be driven by strong demand for smaller spaces, as the average amount leased hovers at just over 3,000 square feet, a new all-time historical low. The heightened leasing activity for smaller spaces is being overwhelmingly driven by the growth in store counts for quick service restaurant brands such as Starbucks, Crumbl Cookies, Yum Brands and Restaurant Brands International, the owner of BK, Tim Hortons, Popeyes and Firehouse Subs chains. Cellular retailers T-Mobile and AT&T have also been in expansion mode, signing for dozens of new smaller shop spaces this year.

Demand for medium to larger retail spaces has been primarily driven by discounters such as Dollar Tree and Dollar General, including its new pOpshelf concept, as well as by off-price retailers such as TJ Maxx and Burlington.

The quarter also saw an uptick in leasing volume from fitness centers and experiential tenants, as pandemic-related restrictions have eased and consumers have grown more comfortable returning to pre-pandemic behaviors.

After accounting for between 8% and 10% of all retail leasing activity in each year since 2015, experiential retailers have ratcheted up their expansion. Led by Planet Fitness and Urban Air Adventure, these types of retailers accounted for approximately 15% of all leasing activity since the start of the year.

Consistent leasing activity and a pullback in move-outs pushed demand for retail space higher by 16 million square feet during the third quarter, marking the seventh consecutive quarter of positive absorption, the net change between the amount of space occupied and vacated. The vast majority of this increased demand was concentrated on freestanding properties or smaller retailer centers.

Freestanding properties remain in high demand from quick-service restaurants, discounters and big-box retailers in the department store, home goods and decor and home improvement categories. Smaller centers meanwhile have benefited from strong demand from grocers for anchor space and a resurgence in demand for shop space from both local and national tenants.

While the U.S. retail space market saw another quarter of growth, it remains an open question how long that leasing momentum will be sustained. Retail tenants are facing significant costs pressures on seemingly every line item, and certain costs, such as labor and transportation, appear unlikely to decrease anytime soon.

The U.S. consumer is showing signs of fatigue as pandemic-era surpluses wane, the savings rate dips to worrisome levels and the negative wealth effect of lower real and financial asset prices take hold. While the strong retail leasing trends seen in the third quarter were a welcome sign of continued retail expansion, especially among smaller tenants, the probability has grown that the U.S. retail market's recent expansion may run out of steam in 2023.