Grocery-Anchored Shopping Centers May Offer Investors Shelter in an Economic Storm

Retail Properties With Grocers Attached Offer Stability in Hard Times and Face Low Competition From E-Commerce

Essential retailers, such as grocers, typically see stronger consumption relative to discretionary retailers, such as restaurants, in a weaker economy. (Getty)

By Andrew Zola and Kevin Cody
CoStar Advisory Services

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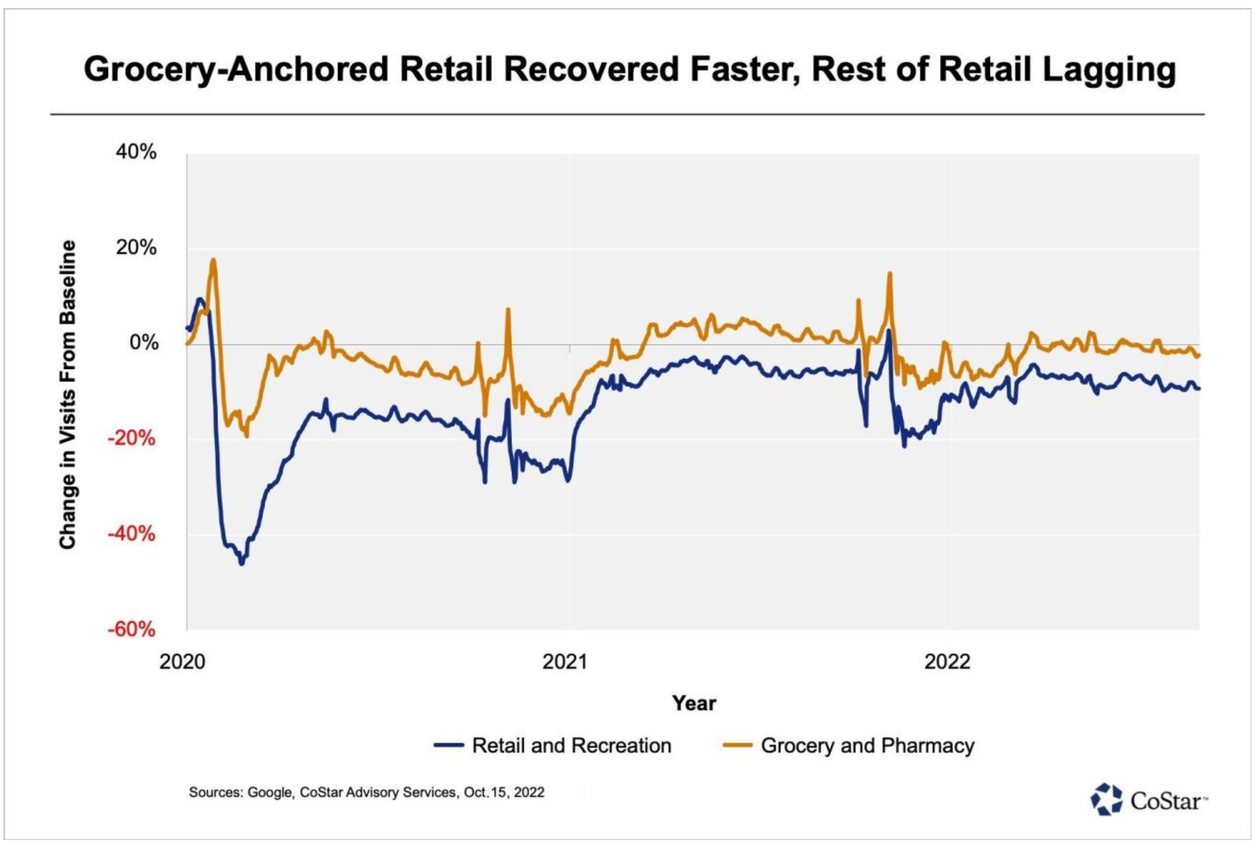
As the U.S. economy heads toward a likely recession, grocery-anchored shopping centers appear once again to be well positioned to weather the storm, much as they did during the initial stages of the pandemic.

Two of the most compelling cases for investment in grocery-anchored retail are its stability during economic distress and its relatively low competition from e-commerce. The pandemic spotlighted both attributes, as grocery sales were among the most resilient in 2020, a time when consumer spending shifted from discretionary and in-person experiential shopping toward necessity and online shopping.

While experiential shopping has shown signs of recovery as cases of the virus have diminished, e-commerce sales were still 60% higher in the second quarter of 2022 compared to before the pandemic, while in-store sales were only 28% higher.

This jump in e-commerce shopping was a key reason retail and recreation foot traffic, tracked by Google, fell so dramatically at the start of the pandemic and has yet to return to pre-pandemic levels. Conversely, foot traffic at grocery stores and pharmacies held up much better at the beginning of the pandemic and has essentially returned to pre-pandemic levels since early 2021.

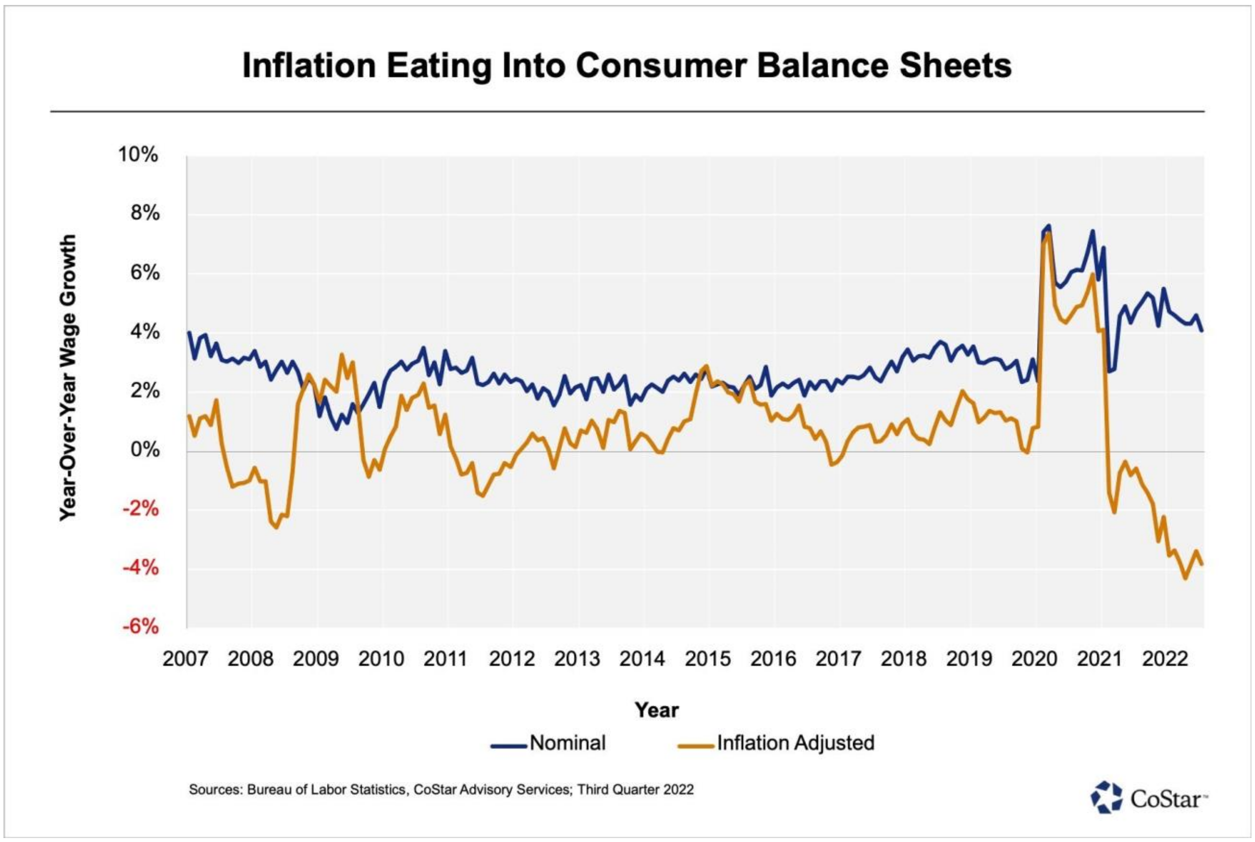
As of Oct. 15, total retail and recreational foot traffic was 8% below pre-pandemic levels, while grocery and pharmacy foot traffic was only down 1%. While the virus forced many nonessential retailers to temporarily close, as an essential service, grocery stores remained open and their foot traffic and sales further benefited from the closing of dine-in restaurants. Heading into 2023, it’s important to remember that essential retailers, such as grocers, typically see stronger consumption relative to discretionary retailers, such as restaurants, in weaker economic environments.



Persisting inflation is also continuing to eat into the incomes of consumers, which will probably discourage spending on discretionary goods and services, particularly as the economy slows and with possible job losses on the horizon. Inflation-adjusted wages are down 3% year over year, even though nominal wages are up 4%, showing the impact inflation is having on consumer spending power.

Consumer balance sheets are still healthy thanks to savings that were accumulated earlier on in the pandemic. But with stimulus payments in the past, inflation continues to eat into those savings.

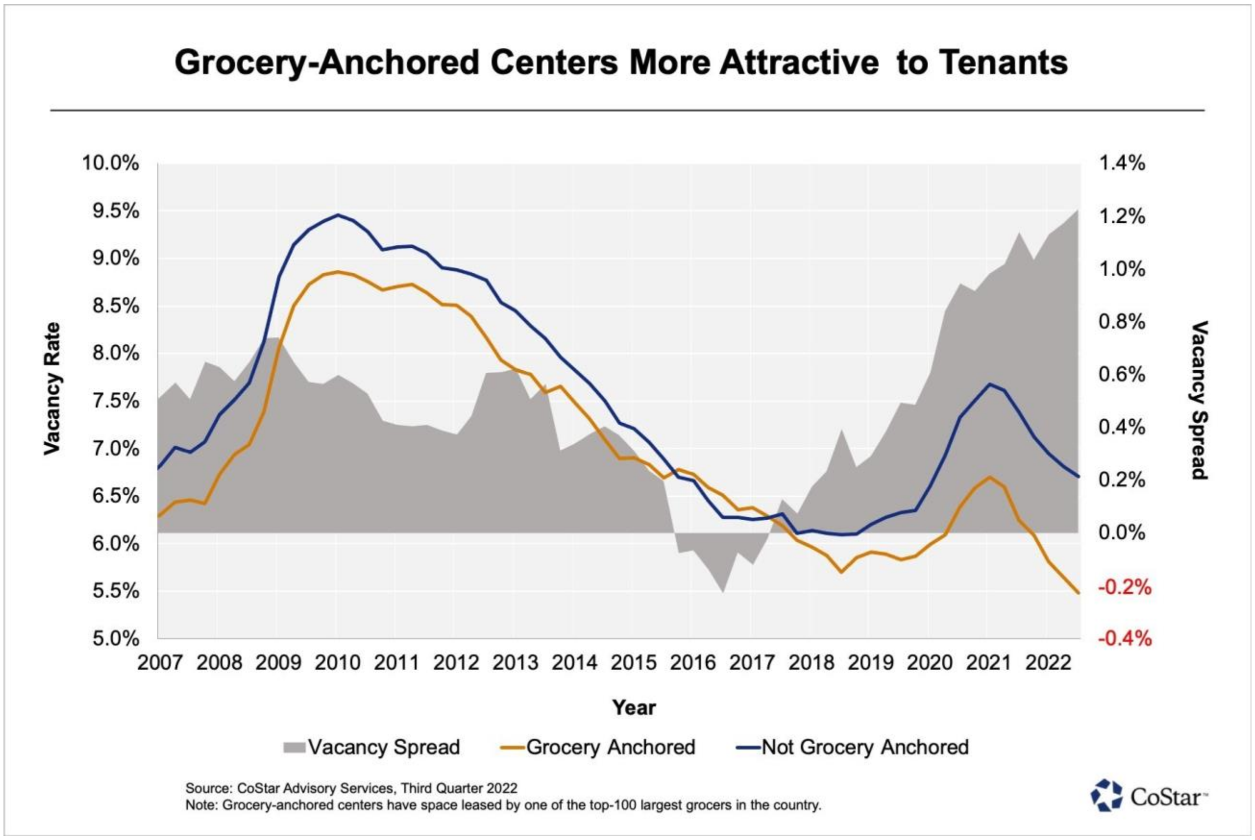
Restaurant sales have also outperformed in 2022, due to a recent shift back toward experiential shopping and socializing as cases of the virus fall. However, with consumer sentiment sitting around all-time lows, consumers facing diminishing spending power and the economy heading into a possible recession, the likelihood of continued strong restaurant sales is in question.



All these macro trends have resulted in strong demand from grocery tenants as well as inline tenants within grocery-anchored shopping centers. This strong demand, coupled with limited supply growth, has led to tighter vacancies in grocery-anchored centers. Grocery-anchored vacancies sit at 5.4% as of the third quarter, 50 basis points below their pre-pandemic vacancy of 5.9%. This is compared to nongrocery-anchored centers, which have an average vacancy of

6.7%, still above its pre-pandemic level of 6.6%. This has led to a vacancy spread of 1.2% as of the third quarter, the highest spread seen since before the Great Recession.

Much of the recent retail vacancy expansion in shopping centers without a grocery anchor can be attributed to regional and super regional malls, as those center types have experienced the most significant negative impact to foot traffic and the largest vacancy expansions since the start of the pandemic.



With persisting inflation and rising rates pushing the U.S. into a possible recession, grocery-anchored retail should remain a source of stability within the retail sector.

Andrew Zola is a consultant and Kevin Cody is a strategic consultant for CoStar Advisory Services.