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Opening Session

The President Speaks: The Post-Pandemic Economy & Consumer Conditions

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by:

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Introduction

As the largest consumer-facing industry and the heartbeat of America's communities, the retail real estate industry closely mirrors the ever-changing tapestry of consumer behavior and economic trends. While the industry has faced many challenges, notably from the pandemic, its resilience and adaptability are undeniable. To ensure that those in the industry remain prepared for changes that are to come, it is vital to understand the changes that have occurred and recognize how they have resulted in the current state of the industry.

Economic and Consumer Conditions

Since the beginning of the pandemic, the economy and consumers have significantly evolved, driving our industry to also adapt.

Key economic indicators reveal dramatic shifts. The effective federal funds rate rose from 0.05 percent to 5.33 percent, reflecting a significant tightening of monetary policy by the Federal Reserve in the effort to address inflationary pressures. The inflation rate increased from 0.3 percent to 3.3 percent, indicating a significant increase in the overall cost of goods and services across the nation. The 10-year treasury yield rose from 0.66 percent to 4.32 percent, potentially reflecting expectations of a stronger economy or higher inflation.

Looking at the big picture, the United States is facing a growing debt burden. Budget deficits are projected to exceed $3 trillion within a decade. In 2023, United States interest payments on its debt were 2.4 percent of gross domestic product, with that amount projected to grow to 3.9 percent by 2034, according to the Congressional Budget Office, which highlights the growing cost of servicing the national debt. As of March 2024, monthly interest on the debt was 3.2 percent. As interest rates rise, the government will need to allocate more of its budget to debt payments, potentially causing a decrease or elimination of spending on other national spending priorities.

On the consumer side, unemployment declined from 14.8 percent to 4.3 percent, reflecting a strong job market. The personal savings rate declined from 32.0 percent to 3.6 percent, in line with higher prices as consumers spend a larger portion of their income and save less. Consumer confidence increased from 85.7 to 100.3, but it has remained in a narrow range over the past two years. While consumers remain relatively positive about the labor market, they are still concerned about elevated prices and interest rates and uncertainty about whether economic conditions may improve.

When we look at non-revolving, revolving, and total debt, the data reveals a complex relationship between economic conditions, consumer behavior, and debt accumulation. Between Q1 2020 and Q4 2023, non-revolving, revolving, and total debt grew by 23 percent (from $12.6 trillion to $15.5 trillion), 15 percent (from $1.3 trillion to $1.5 trillion), and 22 percent ($13.9 trillion to $17 trillion), respectively. Revolving debt decreased by 15 percent between Q1 2020 and Q1 2021 from $1.3 trillion to $1.1 trillion) when the benchmark rate was 0.0 percent and stimulus payments had been sent, allowing consumers to pay down balances and lessen the burden of future payments weighted with interest. The increases in debt suggest that consumers have been relying more heavily on credit to finance their purchases, which may be attributed to factors like increased living costs. The sustained level of debt raises concerns about consumers' financial health and their ability to manage future economic challenges.

When examining consumers' debt obligations, delinquencies across all debt types, excluding student loans, rose in 2023. New delinquencies (30+ days) for credit cards and mortgages grew by 31 percent and 23 percent, respectively, which may suggest that consumers may be struggling to manage their debt obligations and could have negative consequences for both individual consumers and the broader economy.

However, mortgage delinquency remains low when compared to historical levels, and despite no cuts to the benchmark rate, mortgage debt grew by $208 billion, with $112 billion of that increase in Q4 2023. These factors suggest that the housing market remains resilient despite rising interest rates. Despite this, the rising cost of housing continues to remain a major concern for consumer advocacy groups, think tanks and businesses. The American Legislative Exchange Council (ALEC) is

considering several model policies across its task forces. Two in particular aim to reform single-family zoned neighborhoods, with one enabling developers to build more light touch density housing and another enabling multi-family units to be built on properties zoned for single-family homes.

Industry Conditions

In 2023, more than $6 trillion of consumer spending in the United States took place across the retail and food-and-beverage industries, not including auto and gas sales. That figure has grown steadily over the last four years, up 32 percent from $4.6 trillion in 2020 to $6.1 trillion in 2023 and is generated primarily in America's marketplaces.

The retail industry has demonstrated remarkable resilience in the face of economic fluctuations and changing consumer behaviors, outlined above. Despite moderate month-over-month inflation in 2021, total retail sales including food-and-beverage and auto and gas grew 19 percent year-over-year between 2020 and 2021 (from $6.2 trillion to $7.4 trillion). Between 2022 and 2023, total retail sales including food-and-beverage grew by 5.2 percent from $5.8 trillion to $6.1 trillion. In 2024, ICSC is projecting retail sales growth of between 4 percent to 4.5 percent, suggesting a continued positive outlook for the industry.

However, one of the biggest challenges for the retail real estate industry is the lack of new retail space. Between 2008 and the end of 2023, shopping center gross leasable area grew at a substantially slower rate than retail sales, inflation-adjusted gross domestic product, and the United States population. In that time period, retail sales, excluding auto, gas and food-and-beverage sales, grew by 88.8 percent. Real gross domestic product grew by 33.3 percent. The United States population grew by 11.2 percent. However, shopping center gross leasable area grew by only 6.8 percent.

Due to the short supply of retail space, the industry is experiencing strong leasing demand, limited transaction activity and relatively stable delinquency rates. The delinquency rate of commercial mortgage-backed security loans was 6.4 percent in June 2024 and rent collections were at 91.7 percent in June 2024. This is a positive sign for the retail real estate industry, suggesting that most property owners are able to meet their debt obligations.

Since 2019, the last full operating year prior to the pandemic, transaction activity, measured by sales volume and number of transactions, has varied widely. In 2023, sales volume was down nearly 47 percent year-over-year (from $98.3 billion to $52.5 billion) and at its lowest level since 2013, when it was at $41.7 billion. Additionally, the number of sales completed in 2023 was down 28 percent compared to a stronger 2022 (from 52,800 sales to 37,800 sales) and down 35 percent relative to an active 2021 when there were 58,100 sales. While the decline in transaction activity may be caused by rising interest rates, it may also be attributed to the lack of retail real estate compared to significant growth in demand for physical retail.

In terms of demand for physical retail, through Q1 2024, mall occupancy increased 1.0 percentage points from 2023 from 88.5 percent to 89.5 percent, while open air and all shopping center occupancy remained relatively flat. Open air shopping center occupancy went from 93.0 percent occupancy to 92.6 percent occupancy from 2023 through Q1 2024, while total shopping center occupancy went from 92 percent to 91.8 percent occupancy in the same time period. Due to the limited supply of physical retail space, demand is high and vacancy rates are low.

It is important to keep this in mind when looking at the start of the pandemic in 2020, which drove an unusually high amount of retail bankruptcies, resulting in a corresponding high amount of store closings. In 2020, 70 retail bankruptcies drove nearly 5,000 store closings. In comparison, there were 36 bankruptcies in 2017, driving about 2,900 store closings. In 2024, there have been only 10 bankruptcies so far, which drove fewer than 1,000 store closings.

However, despite higher-than-usual bankruptcies and store closings, the industry remained resilient, as store closings enabled other retailers to open new stores and gave landlords the opportunity to revitalize and renovate their properties to better meet consumer prefernces. By the end of 2023, there were 5,300 announced store openings, in line with the previous two years. 2024

openings have been strong, as announced store openings (4,395) continue to remain higher than announced closings (3,028).

While the industry remains resilient, one of the biggest challenges with which we contend today is organized retail crime, a major priority for law enforcement, state lawmakers and retailers. Organized retail crime not only harms communities and retail centers but also threatens the safety of consumers and retail workers alike. Organized retail crime involves a criminal enterprise employing a group of two or more individuals who steal substantial quantities of merchandise from a retailer. Inventory loss in 2022 reached $94 billion and 75.9 percent of retailers reported that organized retail crime resulted in the physical assault of an employee. Lawmakers in several states have enacted legislation to target retail theft networks. Most measures aim to provide prosecutors with more flexibility to charge offenders, increase funding for law enforcement and/or enforce tougher punishment for repeat offenders.

ICSC continues to support legislation that combats organized retail crime. The Integrity, Notification, and Fairness in Online Retail Marketplaces for Consumers (INFORM Consumers) Act was signed into law in December 2022 by President Biden as part of the Fiscal Year 2023 omnibus appropriations bill. This law requires online marketplaces to collect, verify and make available to buyers certain information related to high-volume third party sellers in an effort to add more transparency to online transactions and deter criminals from acquiring stolen, counterfeit or unsafe items and selling them through online marketplaces. The bipartisan "Combating Organized Retail Crime Act of 2023," introduced in the 118th Congress by Senators Chuck Grassley (R-IA) and Catherine Cortez Masto (D-NV) and Representatives Ken Buck (R-CO-04), Dina Titus (D-NV-01), Susie Lee (D-NV-03) and David Joyce (R-OH-14), aims to expand federal enforcement of criminal offenses related to organized retail crime.

The Omnichannel Journey

Since 2009, total physical and e-commerce sales have more than doubled, growing by 104 percent from $4.1 trillion to $8.3 trillion. Individually, physical sales increased by 84 percent from $3.9 trillion to $7.2 trillion and e-commerce increased by 1,000 percent from $100 billion to $1.1 trillion.

At the onset of the pandemic, the dominant narrative about our industry was that physical retail was "dying" and e-commerce would dominate over physical retail. Instead, we observed an overwhelming desire from consumers to be out and about, socialize and share experiences together, and see and try products before buying. 2020, the start of the pandemic, was the first year in which the share of sales attributed to e-commerce rose significantly, increasing 4.1 percentage points over 2019 from 10.6 percent to 14.7 percent, respectively. Since 2020, the e-commerce share has remained relatively flat, increasing only 0.7 percentage points from 14.7 percent to 15.4 percent.

Today, we know that the core of the omnichannel experience is the retail store. Despite significant e-commerce growth, physical stores and food-and-beverage places represent 87 percent of total retail spend and retail sales stemming from physical retail are 6.5 times that of e-commerce as of the end of 2023. While industry data shows that the pandemic accelerated the adoption of e-commerce by consumers and retailers alike, it clearly also demonstrates that physical retail remains the dominant force in the retail landscape and a cornerstone of consumer spending.

At the end of 2023, ICSC released a report titled "Where the Halo Shines: How Physical Stores Drive Online Sales," quantifying the impact of opening or closing physical stores on online sales and retailers' overall performance and observations about the youngest cohort of adult consumers, Gen Z. This study was the third installment in ICSC's industry-leading research on the halo effect of brick-and-mortar retail on online sales. The extensive research, spanning in-store and online sales of 69 retailers and 2,103 individual stores, revealed that opening a store boosts online sales in the trade area surrounding that store by an average of 6.9 percent in the immediate weeks following the store's opening. For emerging, direct-to-consumer brands, the benefits are even higher – the correlating halo effect for online sales is 13.9 percent when opening a new store. Conversely, closing stores has an even greater negative impact on retailer performance, resulting in an 11.5 percent drop in sales. The study also examined the impact of opening or closing a store on average basket size, revealing that opening a physical store causes a shopper's average online basket to

increase. For established retailers, the average online basket increased by $10 from $94 to $104 and for emerging retailers, it increased by $9 from $111 to $120.

The importance of a brick-and-mortar presence for retailers is further highlighted in a recent ICSC consumer survey, which measured returns. In-store purchases generate a mere 5.0 percent return rate, three times less than the 15.2 percent return rate for online purchases. The primary reason consumers shop in-store is to touch, feel and try on merchandise.

From ICSC's consumer survey, it is clear that the inability to interact with items before purchasing drives significant, frequent, and often costly, returns. The most common reasons for returning online purchases are damaged item(s) (52 percent), item(s) did not fit (50 percent), item(s) was not as expected (42 percent), and the wrong item(s) was sent (37 percent). To combat the growing logistical and inventory management challenges of online returns, many retailers now charge fees to ship back purchases made online, thereby driving customers to visit a physical store.

Across six types of retailers studied (apparel, big box specialty, cosmetics, department stores, discount department stores and emerging retailers) in ICSC's report, "Where the Halo Shines: How Physical Stores Drive Online Sales," the average online return rate is 23 percent, while in-store purchases have a significantly lower return rate of 6 percent. For each type of retailer studied, the online return rate is at least three times larger compared to the in-store return rate.

- Cosmetics have a 1.1 percent in-store return rate compared to a 7.6 percent online return rate.
- Emerging retailers have a 2.4 percent return rate compared to a 15.5 percent online return rate.
- Apparel retailers have a 6.2 percent in-store return rate compared to a 22.2 percent online return rate.
- Discount department stores have a 6.2 percent in-store return rate compared to a 33.2 percent online return rate.
- Big box specialty retailers have an 8.9 percent in-store return rate compared to a 29.4 percent online return rate.
- Department stores have a 12.0 percent in-store return rate compared to a 30.9 percent online return rate.

Conclusion

The pandemic greatly reshaped the retail real estate industry. While the pandemic presented numerous challenges, such as temporarily shutting down physical retail, it also accelerated several beneficial trends and highlighted the need for adaptability. The rapid adoption of e-commerce and omnichannel solutions, the changing United States economy, and shifting consumer preferences and behaviors have forced our industry to rethink business models and strategies and prioritize the consumer experience in different ways.

Looking ahead, our industry will continue to evolve. While we can anticipate and plan for some impacts, trends and challenges, ongoing economic uncertainties, geopolitical factors, and evolving consumer preferences will likely shape the landscape in the coming years.