Buying time: Austin's retail market can wait out the pandemic

BY MATT BAKER

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Think back in time five quarters or so. At the end of 2019, brick-and-mortar retail was feeling the pinch of e-commerce. Virtually everywhere in the country, landlords struggled as storefronts went dark. Virtually everywhere, that is, but not in Austin.

"We were not experiencing pre-pandemic challenges in market demand within the Austin MSA," said Kevin Murphy, vice president on NAI Partners' retail services team in Austin. "The increased cost of property taxes was causing downward pressure on rates. Nonetheless, development and demand remained healthy."

The key component of this unexpected performance is population growth. Between 2010 and 2019, U.S. Census figures show that Austin grew by over 177,000 residents, moving up the country's list of most populous cities from 14th to 11th. Where the people go, so to do physical retailers, even in the age of online shopping.

That was 2019; then 2020, of course, altered the trajectory of this and every other asset class. With COVID-19 leaving patrons unable or unwilling to go out to restaurants, stores, bars, bowling alleys and every other type of retail establishment, the sector took a hit.

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But again, Austin's retail market proved to be slightly more resilient to the effects of the pandemic. According to NAI Partners data, the metro's year-to-date retail occupancy rate at the end of October 2020 hovered around 95.2 percent. That's nearly on par with the year-to-date figures from the previous October, which stood at 95.7 percent.

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The proof is in the numbers. The year-to-date absorption last October stood at 456,319 square feet. While this was indeed a drop off from the 701,889 square feet over the same time span one year prior, it's still positive retail absorption, which is more than most other markets around the country can claim.

That's also impressive as nearly 1.1 million square feet of new retail space came to market in 2020 as of the end of October, 77 percent of which is occupied (compared to the 870,000 square feet delivered to the Austin metro retail market one year prior).

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Most of the new space is being built in the Cedar Park, Leander and Hutto submarkets—in addition to a few in-fill developments such as the HEB on South Congress with two surrounding shadow anchored developments. One thing that Austin shares with the rest of the country is that new retail properties are far smaller than the sprawling developments of years gone by.

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Experiential retailers—the gyms, bars, cafes and any other storefront that offers an experience that is unimpeded by e-commerce growth—were meant to be the savior of retail landlords prior to the pandemic. These were the hardest hit, however, once COVID-19 came ashore. According to Murphy, however, there has already been an increase in the traffic among experiential retail tenants. He expects numbers will continue to increase as consumers trend more in this direction once they begin to feel safer.

As is the case nationally, the single-tenant, net lease market continues to be the strongest subset within the retail sector. Murphy and his team continue to witness solid fundamentals and investor interest for neighborhood centers. That’s not to say that other retail properties are completely radioactive.

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While population growth for the Austin metro is encouraging, tourism took it on the chin in 2020. In March, organizers of SXSW canceled the annual tech, music and film conference that is typically hosted downtown. In October, the Austin City Limits music festival went virtual. This had a real, economic impact as every $1 spent on a concert generates $12 in economic activity, according to the National Independent Venue Association.

Barracuda, Threadgill’s and at least four other Austin music venues have ceased operations due to the pandemic, with more in jeopardy. While some retail and entertainment locations will go dark for good as a result of the pandemic, the overall sector is expected bounce back fairly quickly in Austin, once the virus is under control.

But what will that rebound look like? How differently will the retail development of tomorrow look and operate contrasted with how it has in the recent past? There likely will be some lessons learned from the pandemic and best practices to be implemented in response to consumer behavior. Murphy believes, for example, that retail centers will be smaller and more efficient, and we will likely see an increase in drive throughs and outdoor seating.

“Looking at the increased market values of Amazon and others in the e-commerce world—and the pivot by many traditional retail consumers in realizing the convenience of these services—big boxes will not be in every submarket. They will be more strategic and scaled to meet the shift in buying habits,” said Murphy. “Traditional malls will continue to be re-purposed into ‘lifestyle centers,’ such as Highland Mall and Lakeline Mall, creating a live-work-play environment.”

Austin is proof that people really are the center of commercial real estate, as it is an influx of residents that are buoying a troubled sector during its darkest hour. Time will tell how strongly—and in what capacity—the retail asset class can thrive.