

U.S. COMMERCIAL REAL ESTATE MARKET

Retail's rebound: The case for selective, institutional conviction

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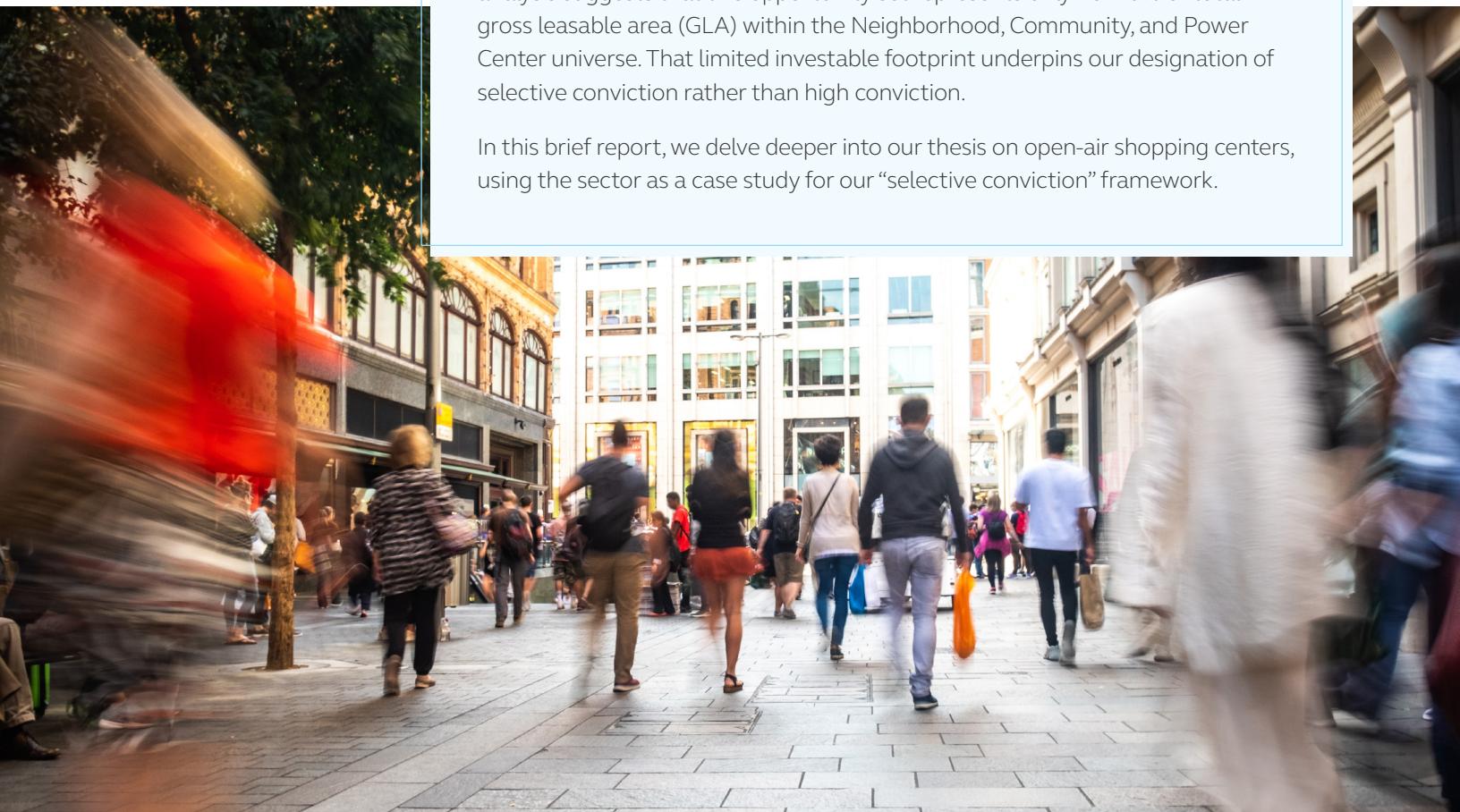
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EXECUTIVE SUMMARY

In our [2026 Global Real Estate Outlook](#), A Cycle for Selectivity, we introduced the concept of “selective conviction” for several property types, including retail. These are sectors that have become increasingly nuanced—where risks are more differentiated, but opportunities still exist or are beginning to emerge.

Some investors have asked why we don’t have “high conviction” on retail, given that many institutional investors remain underweight the sector despite strong fundamentals and attractive recent returns. The short answer is that we are constructive on institutional-grade shopping centers. However, our analysis suggests that this opportunity set represents only ~6–10% of total gross leasable area (GLA) within the Neighborhood, Community, and Power Center universe. That limited investable footprint underpins our designation of selective conviction rather than high conviction.

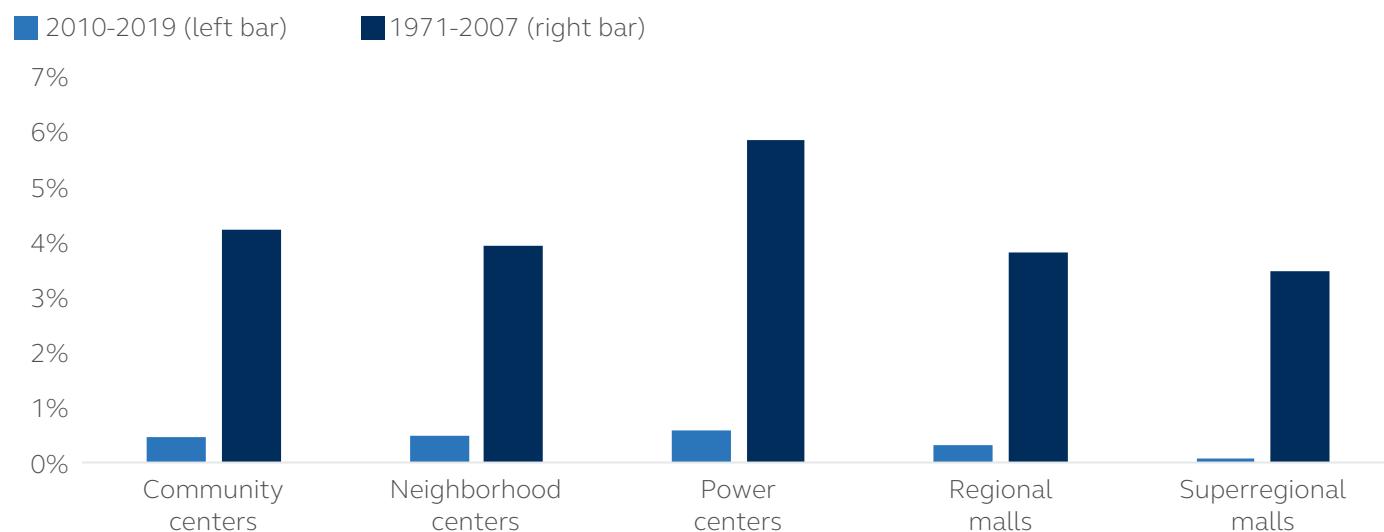
In this brief report, we delve deeper into our thesis on open-air shopping centers, using the sector as a case study for our “selective conviction” framework.



On stronger footing

Retail real estate faced a so-called “retail apocalypse” that is often attributed to e-commerce, yet overbuilding was a deeper driver. Minimal new development over the past decade, combined with COVID serving as a Darwinian event, reshaped the sector. Today, tenant demand has rebounded as physical stores remain essential in an increasingly omni-channel world: [~80% of shopping still occurs in-store](#), and nearly half of [retail executives](#) plan moderate-to-significant investments in physical store remodels or new locations.

EXHIBIT 1: Retail real estate GLA growth collapsed since 2010



Source: ICSC, Principal Asset Management as of 2Q25

Strong fundamentals...

Open-air shopping centers, including neighborhood, community, and power centers, have emerged from the post-COVID period on a strong fundamental footing.

- **Occupancy rates** have risen to 94.2% for neighborhood centers, while community centers and power centers stand near 92.3% as of 2Q25, according to the International Council of Shopping Centers (ICSC).
- **Net operating income (NOI)** per square foot for community centers accelerated to 9.0% post-2020, compared with 2.1% from 2010–2019. Neighborhood centers increased from 4.1% to 5.7%, while power centers remain steady at 4.5%.

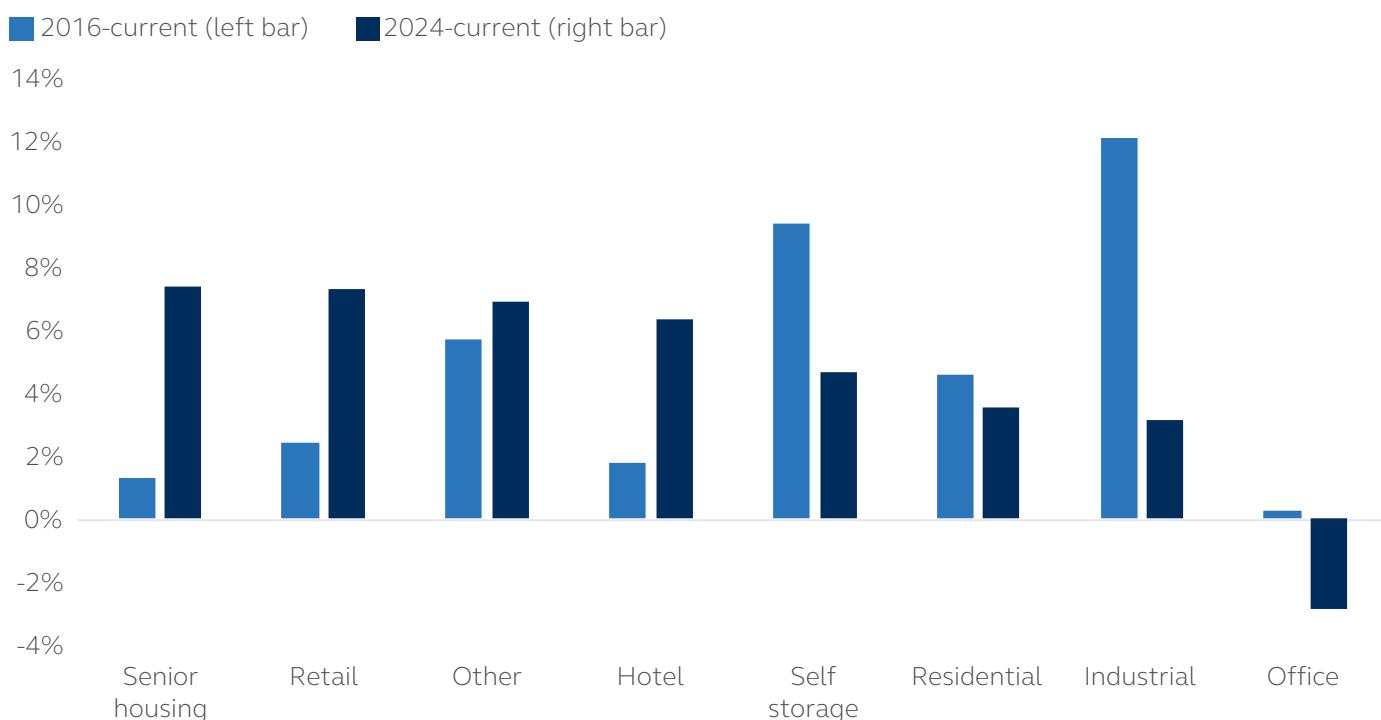
We expect rents and NOI to continue growing due to:

- Open-air shopping centers trade roughly 50% below replacement cost, creating meaningful barriers to entry.
- Expanding tenant demand, with large anchors such as Walmart, Target, and Dick's, and junior tenants like Ross, T.J. Maxx, and Ulta increasing their footprints in community and power centers.

...And attractive returns

Unlevered IRRs for open-air shopping centers exceed those of other core property types, and leverage remains accretive. Retail has emerged as one of the top-performing property types over the past 18 months. Despite this, institutional exposure is still limited—ODCE funds allocate only about 10% to retail, compared with a historical average of 25%.

EXHIBIT 2: Property type annualized total returns - NCREIF ODCE index



Source: NCREIF, Principal Asset Management as of 3Q25

However, nuance is required

There are nearly 116,000 shopping centers in the U.S., according to the ICSC. While malls have dominated headlines over the past 10–15 years, they account for only ~15% of total Gross Leasable Area (GLA). In comparison:

- Neighborhood centers: ~31% of GLA
- Community centers: >25% of GLA
- Power centers: ~13% of GLA

These categories are heterogeneous, making demographics a critical factor in defining “institutional quality.” Our analysis suggests that the universe of institutional-grade properties is small—roughly **6–10% of total GLA** for neighborhood, community, and power centers.

For context, publicly traded shopping center REIT portfolios have average populations within a 3-mile radius of ~152k and average household incomes of \$155k. Using a wider screening threshold—population >100k within a 3-mile radius and average household income >\$100k—only 12% of power centers, 10% of community centers, and 9% of neighborhood centers qualify as institutional based on GLA.

Adding a median home value filter of $\geq \$500k$ (aligned with typical REIT portfolios) reduces the share of institutional-quality properties to 7% for community centers, 6% for neighborhood centers, and 6% for power centers.

EXHIBIT 3: Analysis of institutional cohort of retail real estate

	Institutional cohort					
	Total		No home value flag		>\$500k home value	
	GLA	% of Total	GLA	% of Total	GLA	% of Total
Super regional mall	690	9%	146	19%	112	16%
Regional mall	311	4%	27	8%	20	6%
Community center	1,900	25%	189	10%	111	6%
Neighborhood center	2,300	31%	216	9%	142	6%
Power	1,000	13%	121	12%	73	7%
Strip	970	13%	34	4%	20	2%
Lifestyle	217	3%	34	20%	22	10%
Factory outlet	101	1%	0	0%	0	0%
Theme festival	20	0%	1	3%	0	2%
Airport retail	8	0%	0	1%	0	1%
Total	7,517		768	10.2%	501	6.7%

Source: NCREIF, Principal Asset Management as of 3Q25

Considering that REITs already own over 2,100 properties across neighborhood centers (~370), community centers (~495), and power centers (~546), there may be a limited number of properties nationwide that meet “institutional quality” criteria. With capital increasingly flowing into the sector, this limited supply suggests that cap rates are likely to continue tightening in the coming quarters and years, making it one of the few property sectors where such a trend can reasonably be expected.

Conclusion

Retail real estate has emerged as a compelling but highly selective opportunity. While fundamentals are strong and returns attractive, truly institutional-grade properties represent only 6-10% of the open-air shopping center universe. For disciplined investors focused on high-quality assets in strong demographic markets, retail offers the potential for continued outperformance and cap rate compression—but this remains a story of selectivity, not broad-based opportunity.

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