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Small Business Checkpoint

Inflation continues to raise rent

15 August 2024

Key takeaways

- Inflation remains a top concern for small businesses, and has been noticeably persistent in rent payments. According to Bank of America internal data, rent payments per small business client increased 11% year-over-year (YoY) in July, twice as high as rent of shelter inflation reported in the Consumer Price Index (CPI) report.
- Higher rent can cut into profit margins, especially for small businesses with smaller revenues. In fact, those with revenues <$500K which includes microbusinesses, not only have seen an acceleration in rent payment growth but also a decrease in their inflow-to-outflow ratio, which we view as a proxy for profits.
- Across industries, small businesses in the retail sector have experienced the greatest increase in share of rent in total payments. More specifically, those in the South paid around 25% more in rent payments in July than the 2019 average, likely in part reflecting recent domestic migration trends.

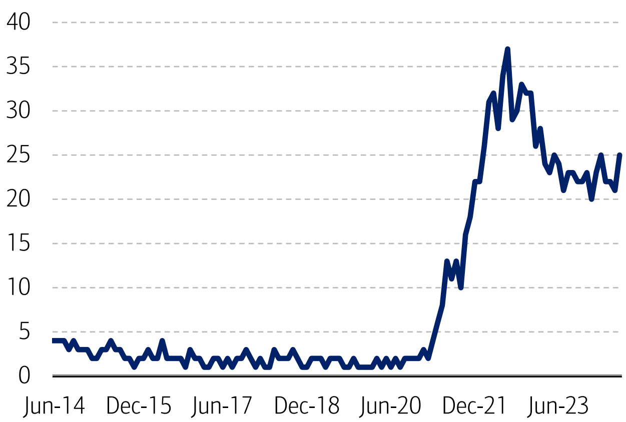
Small Business Checkpoint is a regular publication from Bank of America Institute. It aims to provide a real-time assessment of small business spending activities and financial well-being, leveraging the depth and breadth of Bank of America's proprietary data. Such data is not intended to be reflective or indicative of, and should not be relied upon as, the results of operations, financial condition or performance of Bank of America.

Inflation remains top concern for small businesses

Small business (SB) optimism in July reached its highest level since February 2022, according to the National Federation of Independent Business (NFIB). However, it is still below the fifty-year historical average, and the survey suggests that a strong factor behind small business owners' decline in confidence over the past several years is due to inflation. In July, 25% of owners reported inflation as the single most important problem for operating their business (Exhibit 1).

Exhibit 1: Small businesses reporting inflation as the single most important problem remains historically high at 25% in July

Single most important problem: percent reporting inflation (%)



Source: NFIB

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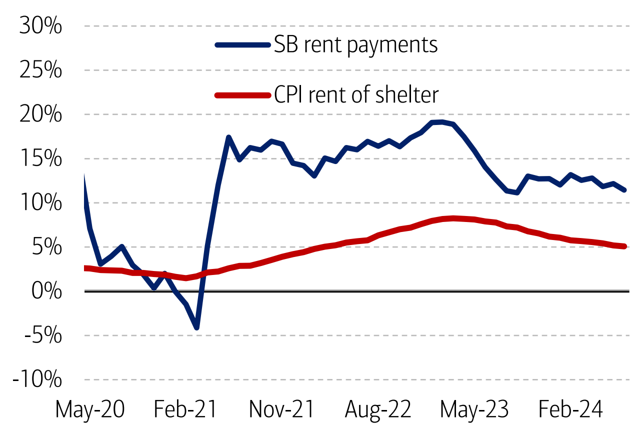
Exhibit 2: Rent payment growth is down from its peak in early 2023, but increased around 11% YoY in July and is rising at a faster rate than overall rent prices in the CPI

Rent payment growth per small business client (three-month moving average, %YoY) and CPI rent of shelter (seasonally adjusted (SA), YoY%)



Source: Bank of America internal data, Bureau of Labor Statistics

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One aspect of inflation particularly impacting small businesses may be rent inflation. Looking at Bank of America internal data on small businesses, focusing on accounts making ACH (automated clearing house), we find that monthly rent payment growth per small business client was up around 11% YoY in July on a three-month moving average basis (Exhibit 2). This is twice as high as the CPI's measure of residential rents.

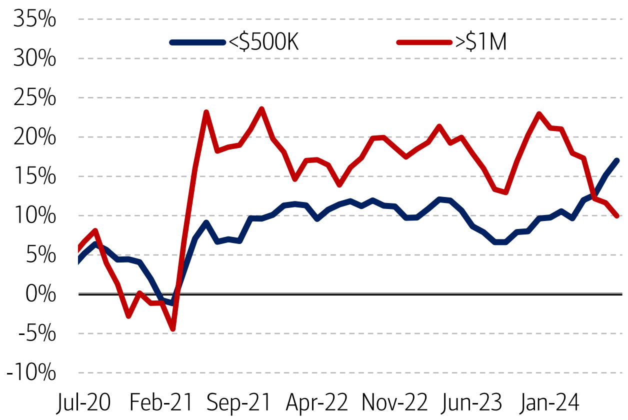
Is rent squeezing smaller firms' profits?

Rental pressures vary across small businesses. Within Bank of America internal data, small firms with revenues of less than $500K, which includes microbusinesses (revenues of less than $100K), are feeling a greater squeeze from persistent rent growth (Exhibit 3) than their larger counterparts. We find there has been a steady increase in rent payment growth per small business client since the end of last year for this cohort. Yet, conversely, small businesses with revenues exceeding $1M have experienced decelerating rent payment growth over the past seven months.

While it is possible accelerated rent payment growth amongst firms with smaller revenues may reflect their expansion, according to the NFIB, the percentage of businesses reporting that now is a good time to expand is historically low - registering only 5% as of July (Exhibit 4).

Exhibit 3: Firms with more revenue are experiencing deceleration in rent growth whereas those with smaller revenues are seeing a steady increase since the end of last year

Rent payment per small business client by revenue tier (three-month moving average, YoY%)



Source: Bank of America internal data

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Exhibit 4: As of July, the percentage of businesses reporting now is a good time to expand is only 2% higher than in April 2020

Percent reporting now is a good time to expand (SA, %)

Source: NFIB

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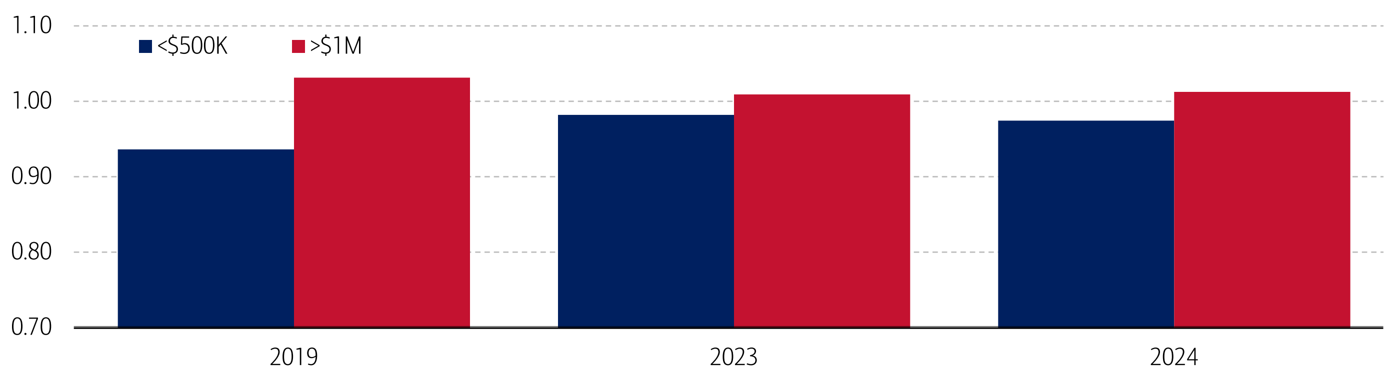
It seems possible therefore that high rent growth may be squeezing businesses with small revenues' profitability and Bank of America internal data suggests this is the case. We find the ratio of inflows-to-outflows in small business checking and savings accounts, which we view as a proxy for profits, has declined from the first half of the year for firms with smaller revenues whereas profits for higher revenue firms have slightly increased (Exhibit 5). The good news though is profit levels for these businesses as of the January-July 2024 average are higher than the 2019 average level.

Exhibit 5: Firms with smaller revenues have elevated profit levels compared to 2019 but have declined since last year, and small businesses with higher revenues are opposite of that

Inflow-to-outflow ratio by small business revenue tier (January-July average by year)



Source: Bank of America internal data

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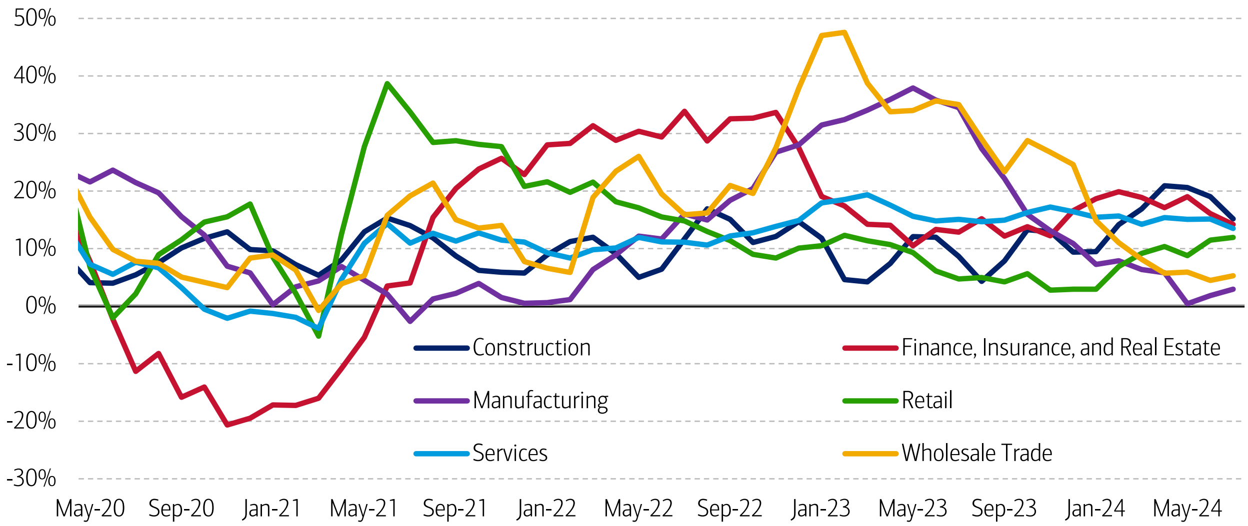
Small business retailers are facing increased rent payment pressure

Looking across industries, Bank of America internal data indicates that many industries have declined from peak rent payment growth per small business client in line with the overall trend (Exhibit 6). The biggest pullback was in wholesale trade and manufacturing. However, retail was noticeably high in the summer of 2021, and finance hit peak rent payment growth at the end of 2022.

But it is noteworthy that, for small businesses in the retail sector, there has been a renewed rise in rental payment growth over 2024. And Exhibit 7 shows that the change in the share of rent in retail firms' overall payments is high compared to other industries. In fact, in July, retail exhibited the greatest increase in the share of rent in total payments.

Exhibit 6: Rent payment growth per small business client in July was highest in construction, finance and services, though has been trending downward in these industries over the past few months. Retail and manufacturing rent payment growth per small business client, however, has been gradually increasing in recent months.

Rent payment per small business client by industry (three-month moving average, YoY% growth)



Source: Bank of America internal data

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One reason for this is that, unlike other industries, retailers require space that draws foot traffic – which makes physical location more important to their business models.

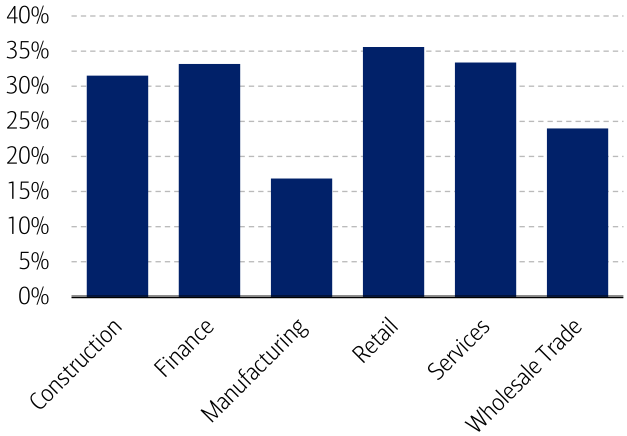
When we look across the country, we find retail rents have risen fastest in the South. According to Bank of America internal data, small businesses in the South are paying around 25% more in rent payments in July than the 2019 average, while for those in the Northeast this figure is 15% (Exhibit 8). Interestingly, the trend in rental payments for retail small businesses in the South was broadly in line with those in the West until mid-2022.

In our view domestic migration trends are likely a key factor to this story, as more people, and possibly more small business owners, have moved into the South and out of the West (See report: On the Move), putting pressure on the supply of suitable property in this region. There has also been a rise in online retail spending in the West, suggesting that more small businesses could be moving to an online-only presence in the West (See report: Will the West take flight?).

Aside from the South, the Midwest has also experienced a notable increase in rent payments over the last six months, with a gain of approximately 6% since the start of this year and 5% since July 2023 per Bank of America internal data. Some of this may reflect strength in consumer spending demand in the region, and an overall solid labor market (See report: Midwestern progress).

Exhibit 7: Compared to last year, small businesses in retail experienced the greatest increase in the share of rent in total payments in July

Change in share of rent payment growth by industry in July (three-month moving average, YoY%)



Source: Bank of America internal data

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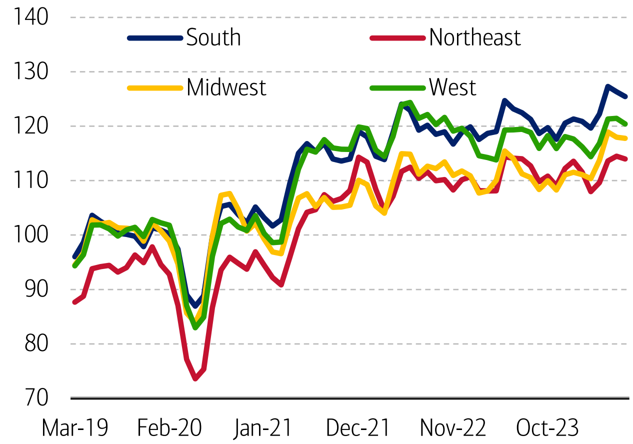
Exhibit 8: Across US Census regions, retail small firms in the South were paying around 25% more in rent than the 2019 average, whereas retail small firms in the Northeast have seen increases of 15%

Retail rent payments per small business client by Census region (three-month moving average, indexed, 2019 average = 100)



Source: Bank of America internal data

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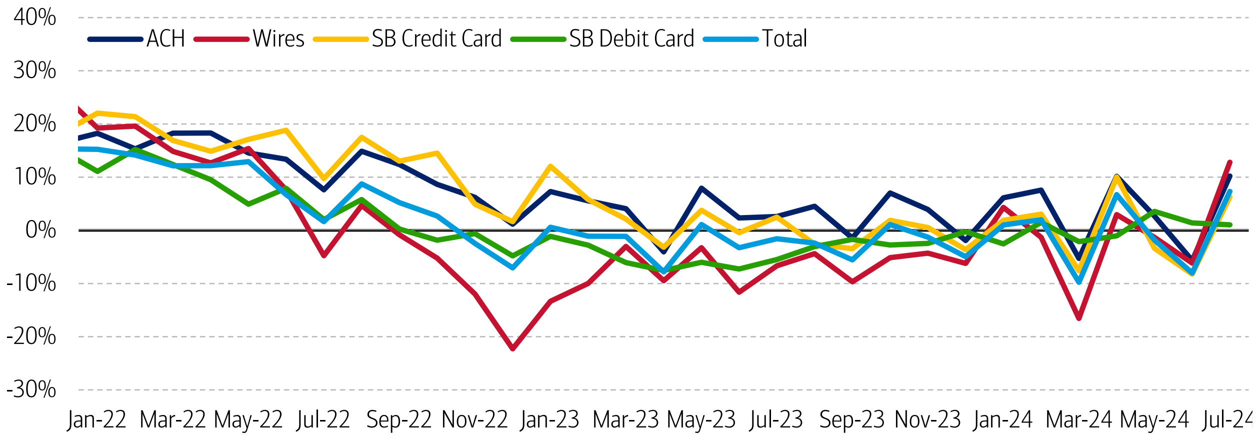
Monthly payments update

Looking more broadly at small business payments in July, according to Bank of America internal data, total payments per small business client increased 7.3% YoY following the 8.0% YoY decline in June (Exhibit 9). This is predominantly a normalization effect from last month's dip, making for a lot of variation in the data.

Among the major components, wire payments increased 12.8% YoY in July, and small business debit card payments remained relatively stable around 1.0% YoY growth.

Exhibit 9: Across all channels except debit card, payments dramatically increased in July following the dip in June

Payments per small business client by channel (%YoY, monthly)



Source: Bank of America internal data

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Methodology

Selected Bank of America transaction data is used to inform the macroeconomic views expressed in this report and should be considered in the context of other economic indicators and publicly available information. In certain instances, the data may provide directional and/or predictive value. The data used is not comprehensive; it is based on **aggregated and anonymized** selections of Bank of America data and may reflect a degree of selection bias and limitations on the data available.

Any **Small Business** payments data represents aggregate spend from Small Business clients with a deposit account or a Small Business credit card. Payroll payments data include channels such as ACH (automated clearing house), bill pay, checks and wire. Bank of America per Small Business client data represents activity spending from active Small Business clients with a deposit account or a Small Business credit card and at least one transaction in each month. Small businesses in this report include business clients within Bank of America and are generally defined as under $5mm in annual sales revenue.

Unless otherwise stated, data is not adjusted for seasonality, processing days or portfolio changes, and may be subject to periodic revisions.

Data regarding merchants who receive payments are identified and classified by the Merchant Categorization Code (MCC) defined by financial services companies. The data are mapped using proprietary methods from the MCCs to the North American Industry Classification System (NAICS), which is also used by the Census Bureau, in order to classify spending data by subsector. Spending data may also be classified by other proprietary methods not using MCCs.

Additional information about the methodology used to aggregate the data is available upon request.

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Disclosures