



HOUSTON RETAIL PERFORMANCE UPDATE

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\$499 PER YEAR

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THIRD QUARTER 2005

Absorption Patterns

↑ **682,083 SF absorbed
in 3Q 2005**

↑ **2,504,844 SF absorbed
in the last 4 quarters**

Occupancy Levels

↑ **86.36% overall in 3Q
2005**

Rent Growth

↔ **Overall rents flat at
\$1.57 psf**

Employment Growth¹

↑ **18,600 jobs gained in
September 2005**

↑ **42,000 jobs gained
since September 2004**

It's officially the end of Houston's long summer season, as temperatures have finally dropped and the nights have gotten longer. Although summer lovers mourn the change in seasons, retailers are gearing up, as we are coming upon their favorite season of the year, holiday shopping season. This season, however, is different than the most recent seasons, as the nation is recovering after three devastating hurricanes: Katrina, Rita, and Wilma.

In the wake of the hurricanes many uncertainties abound, as it is unclear how the increase in unemployment brought about by the hurricanes, record high gasoline prices, and high home heating prices will affect consumer spending this year. There is good reason for retailers to be nervous as the Conference Board reported that the Consumer Confidence Index, an indicator of consumers' overall assessment of current conditions, relative to a figure of 100 in 1985, reported it's largest drop in 15 years (18 points) in September, and subsequently dropped another 2.5 points to 85 in October. With increasing consumer uncertainty, Richard Hastings, a retail analyst at Bernard Sands LLC, expects this holiday season will be the most heavily discounted since 2002.

Some retailers are already showing signs of struggle, as Gap Inc, Ann Taylor, and Talbots Inc. reported same-store sales declines in September. All faith should not be lost, however, as Wal-Mart, J.C. Penney, Federated Department Stores, and several teen retailers reported increasing same-store sales in September. High-end retailers like Nordstrom and Neiman Marcus also reported same-store sales increases over the month. And in spite of all the doom and gloom out there, there are those, like the National Retail Federation, that project an increase in holiday sales over last year. A successful holiday season would be welcome, as the economy has already suffered enough these last few years.

1. Texas Workforce Commission, 09/05
Total non-agricultural jobs

ABSORPTION

Houston's retail market continues posting healthy absorption figures, as over 680,000 square feet (SF) was absorbed over the quarter. Quarterly absorption was positive across all retail types, with Community Centers posting the strongest absorption figure of 390,572 SF. Overall annual absorption now stands at over 2.5 million SF, boosted by annual gains in all retail types aside from Regional Malls.

Greater Houston Retail Absorption (12-month Period)

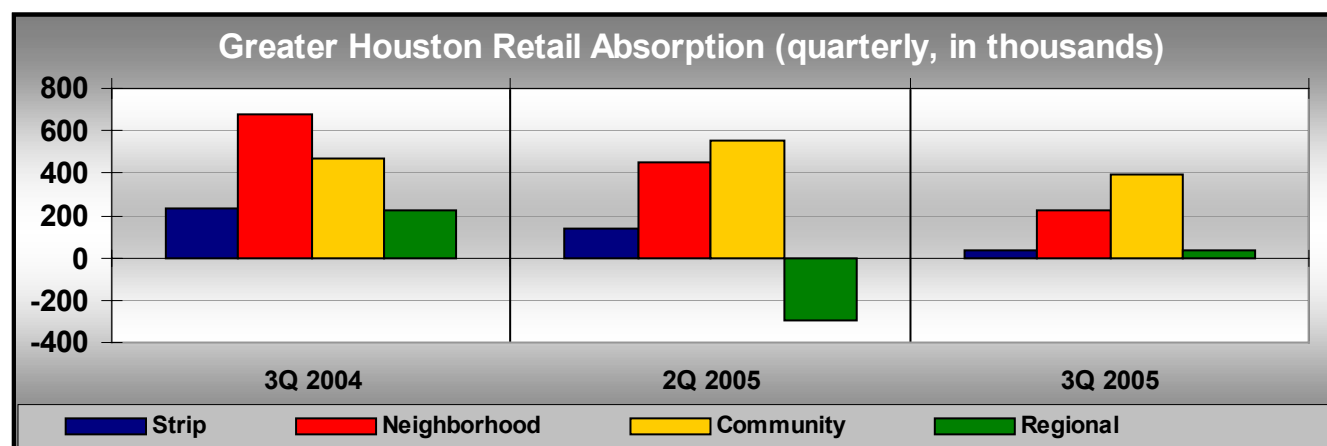
Year Ending	Strip	Neighborhood	Community	Regional	Overall
3Q 2003	493,692	1,637,080	-55,318	536,572	2,612,026
3Q 2004	816,721	2,337,932	2,340,396	859,712	6,354,761
3Q 2005	571,228	1,567,572	872,206	-506,162	2,504,844

After three consecutive quarters in the red, **Regional Malls** are once again in the black, as 32,550 SF was absorbed over the quarter. This quarter's gains, however, were not near enough to bring the annual absorption figure (-506,162 SF) out of the red. The leading sector was the **Far Southeast** sector, which absorbed 169,733 SF over the quarter, followed by the **Near Southeast** sector, which absorbed 29,641 SF over the quarter.

Community Centers outperformed all retail categories this quarter, absorbing 390,572 SF. The leading sectors were the **Far Southwest** and the **Far Northwest**, which absorbed 168,849 SF and 64,804 SF, respectively. The weakest demand was recorded in the **Near Northwest** sector with -30,815 SF absorbed.

Neighborhood Centers continue to post healthy absorption figures, as 222,924 SF was absorbed over the quarter to bring annual absorption to 1,567,572 SF. The strongest demand was recorded in the **Inner Loop**, where over 103,000 SF was absorbed over the quarter. The **Far Northwest** sector trailed the market at -64,709 SF absorbed.

Strip Centers picked up 36,037 SF over the quarter, making this the thirteen consecutive quarter of positive absorption. Demand is highest in the two largest sectors, **Far Southwest** and **Inner Loop**, where absorption was 25,402 SF and 18,393 SF, respectively.



OCCUPANCY

Multitenant retail centers reported a slight increase in occupancy this quarter of 0.12 points. Currently at 86.36%, overall occupancy remains 0.21 points below last year's level. The Community Centers category, which posted a 0.79-point quarterly occupancy gain, was the primary contributor to the overall market's quarterly gain.

Greater Houston Retail Occupancy (Quarterly)

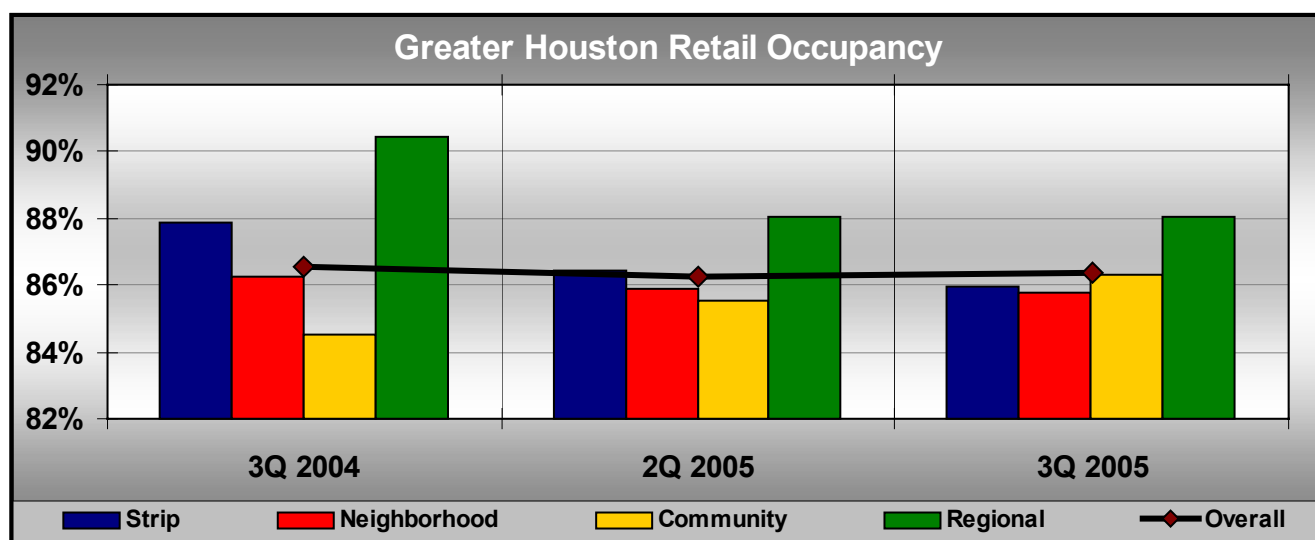
Quarter	Strip	Neighborhood	Community	Regional	Overall
3Q 2004	87.85%	86.26%	84.50%	90.44%	86.57%
2Q 2005	86.46%	85.87%	85.54%	88.04%	86.24%
3Q 2005	85.98%	85.80%	86.33%	88.05%	86.36%

Regional Malls posted a 0.01-point increase in occupancy over the quarter, however, at 88.05%, occupancy is down 2.39 points over the last twelve months. The **Far Southwest** sector with one regional mall, First Colony Mall, posted the highest occupancy at 98.50%. The lowest levels continue to be found in the **Near Northwest** sector at 65.71%.

Community Centers recorded an eighth consecutive quarter of increasing occupancy, as average occupancy increased 0.79 points over the quarter and 1.83 points over the year. At 86.33%, occupancy is at its highest level since the 1st Quarter of 2002. Once again, of the sectors with multiple community centers, the **Inner Loop** posted the highest occupancy at 94.74%, followed by the **Far Southwest** at 90.00%.

Occupancy at **Neighborhood Centers** is down 0.07 points over the quarter and 0.46 points over the year to 85.80%. The **Near Southwest** is the only sector boasting occupancy above 90%, while the **Far North** sector continues to struggle with occupancy at 80.57%.

Strip Centers continued their downward trend, with occupancy dropping 0.48 points over the last quarter and 1.87 points over the last year to 85.98%. Occupancy at Strip Centers is at its lowest level on record.



RENTAL RATES

Overall average rental rates showed no movement over the last quarter. Only Strip and Neighborhood Centers recorded changes in average rental rates, the changes, however, were very slight at \$0.01 per square foot (psf). A little more movement was registered when viewing annual figures, as overall average rental rates gained \$0.03 psf over the year.

Greater Houston Retail Rental Rates (Quarterly)

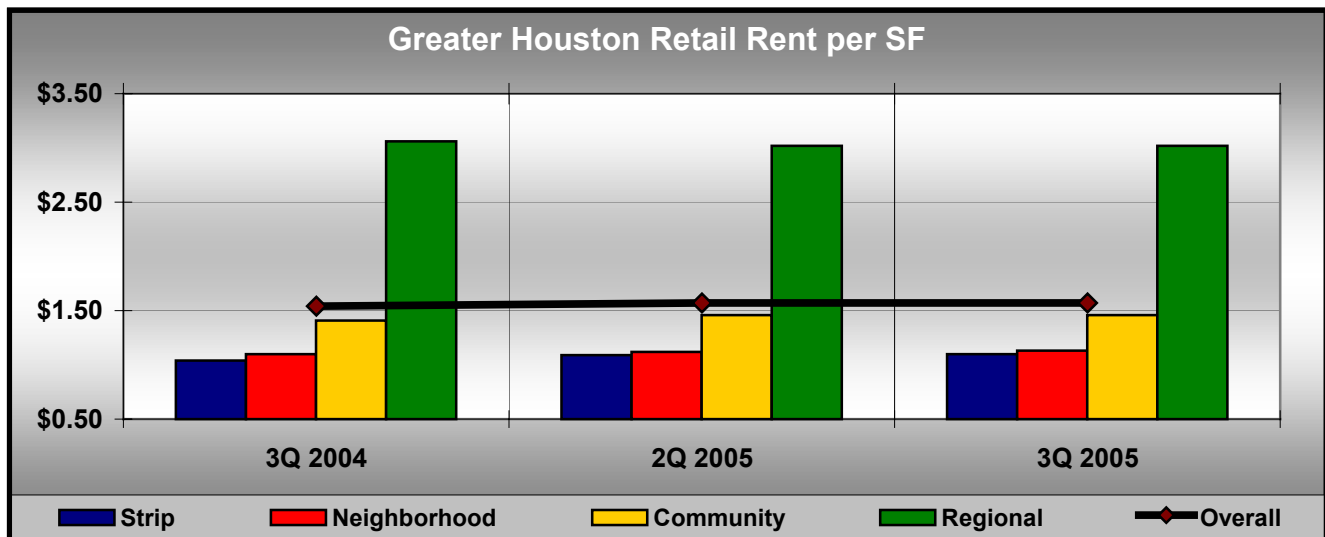
Year	Strip	Neighborhood	Community	Regional	Overall
3Q 2004	\$1.04	\$1.10	\$1.41	\$3.06	\$1.54
2Q 2005	\$1.09	\$1.12	\$1.46	\$3.02	\$1.57
3Q 2005	\$1.10	\$1.13	\$1.46	\$3.02	\$1.57

Regional Mall rents remained unchanged over the last quarter at \$3.02 psf, while average rents are down \$0.02 psf over the last year. Rental rates in the **Near West** were unchanged at \$5.59 psf, and are still the highest among all sectors. **Far Northwest** follows with rents at \$3.50 psf. The lowest rents continue to be found in the **Near Northwest** sector at \$1.82 psf.

Community Center rents also remained flat over the quarter at \$1.46 psf, however they are up \$0.05 over the last twelve months. The spread in rental rates ranges from \$2.18 psf in the **Near West** to \$0.95 psf in the **Near Southeast** sector.

Neighborhood Center rents picked up \$0.01 over the last quarter to \$1.13 psf and are up \$0.03 over last year's level. In this category, the **Near West** sector once again leads the market with average rents at \$1.52 psf, followed by the **Inner Loop** at \$1.47 psf

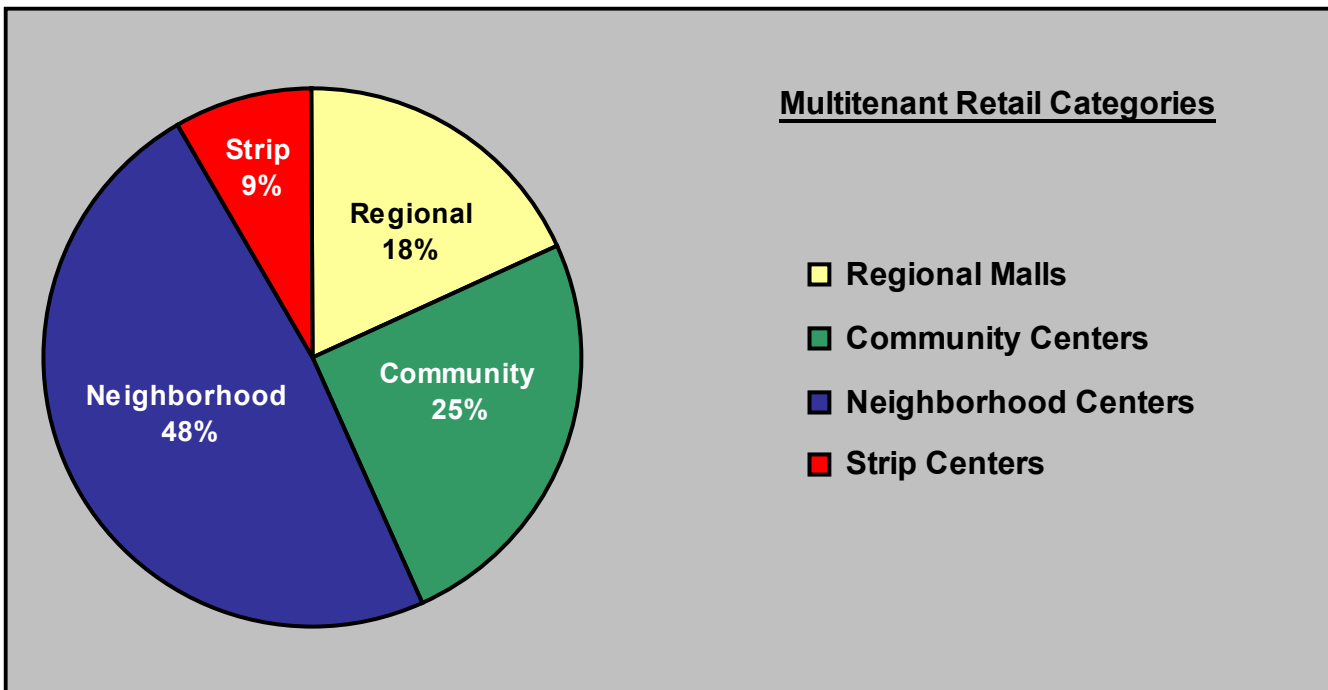
Strip Center rents posted a \$0.01 quarterly gain and \$0.06 annual gain to bring rents up to \$1.10 psf. The highest concentration of Strip Centers can be found in the **Far Northwest** sector, which features 94 centers with average rents at \$1.11 psf.



MULTITENANT RETAIL SPACE BY CATEGORY

O'Connor & Associates divides multitenant retail space into four basic categories for purposes of analysis: Regional Malls, Community Centers, Neighborhood Centers, and Strip Centers. Based on the number of retail centers and square footage, Neighborhood Centers lead other categories with 48% of the overall Greater Houston retail inventory. The second largest category is Community Centers, accounting for 25% of the overall inventory.

Type	Number of Centers	Net Rentable SF
Regional Mall	21	24,070,592
Community Center	140	32,846,645
Neighborhood Center	988	63,645,924
Strip Center	681	11,104,592
Total	1,830	131,667,753



Retail Center Category Definitions

Regional Mall – Contains 600,000 or more net rentable square feet.

Community Center – Contains 150,000 to 599,999 net rentable square feet.

Neighborhood Center – Contains 25,000 to 149,999 net rentable square feet.

Strip Center – Contains 10,000 to 25,000 net rentable square feet.



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Approximately one month ago, O'Connor & Associates published a brief "White Paper" on the impact of Hurricane Katrina on the Houston real estate markets. Much has transpired over the past month and more information is and continues to become available. O'Connor & Associates is pleased to announce that we will be producing an updated and expanded White Paper examining the short- and long-term impact of Katrina upon Houston, particularly the multifamily market.

The expanded White Paper will address:

- Comprehensive analysis of number of evacuees still in Houston and where they have settled throughout the region.
- Impact of evacuees on Houston multifamily market to date, including by region and by class. Analysis of apartment absorption by evacuees.
- Will Katrina evacuees spur significant new multifamily construction in Houston? Should it?
- Projection of long-term population growth from evacuees, including what types of residents are most likely to remain in Houston. Long-term impact of Katrina upon the Houston multifamily and other markets.

This report will be released the week of December 11th and retail for \$2,000. We are offering you a special opportunity to **reserve your copy in advance for the discounted price of \$1,800**. This special offer will expire on November 4th, so please do not delay. All advance buyers will also receive at no additional charge an updated report in September 2006, looking back upon the anniversary of Hurricane Katrina.

To reserve your copy of the report, please fill up the form below and email / fax back today to:

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