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HOUSTON RETAIL PERFORMANCE UPDATE

EDITED BY KATHRYN KOEPKE | $499 PER YEAR | VOLUME 10 NUMBER 1 | FIRST QUARTER 2006

Absorption Patterns

- **-429,215 SF absorbed in 1Q 2006**
- **1,528,115 SF absorbed in the last 4 quarters**

Occupancy Levels

- **85.95% overall in 1Q 2006**

Rent Growth

- **Overall rents up $0.01 to $1.59 psf**

Employment Growth[1]

- **14,800 jobs gained in February 2006**
- **78,500 jobs gained since February 2005**

In the retail community, there is an ongoing discussion about consumers' lack of brand and store loyalty. Chain stores long ago took over the retail landscape, and the mom-and-pop retailer is nearly a thing of the past. Kaplan's Ben-Hur, an independent department store operating in Houston's Heights neighborhood for decades, recently closed amid rising land prices and falling revenues. In contrast, residents of the nearby Woodland Heights neighborhood were recently quoted as being overjoyed about the opening of a brand new Target nearby this summer.

Perhaps one explanation for this change is the blurring line (at least in the minds of some consumers) between discount stores and more traditional retailers. A new upscale Wal-Mart Supercenter in the Dallas suburb of Plano aims to attract those consumers who can be convinced that the term "upscale Wal-Mart" is not an oxymoron, and who are none too pleased to toss sushi in their cart alongside their diapers and economy-size mouthwash. However, considering the popularity of non-"upscale" discount retailers, it appears that the new brand loyalty is price loyalty – simply buy from whoever gives you the absolute lowest price.

Is a price-obsessed public a good thing? On the one hand, few would react negatively to competition in the retail business. And we do get some great deals these days for many everyday items, but many would argue that the money we save is negligible. Will consumers' current attitudes toward retailers last for the long term? Perhaps one day soon, the public will have a change of heart, and those retailers that do not focus strictly on price will enjoy a resurgence. Then again, perhaps they won't, and it will be just a matter of time before Wal-Mart leases the vacant Galleria space.

1. Texas Workforce Commission, 2/06 total non-agricultural jobs

ABSORPTION

The Houston retail market took a step back over the last quarter, posting a negative 429,215 square feet (SF) of absorption, marking the first quarter of negative absorption in 12 quarters. Still-robust construction combined with substantial move-outs, most notably Mervyn's, contributed to the negative figures. Annual absorption remains positive at over 1.5 million SF. Over the first quarter, every category except Strip Centers posted negative absorption, with Regional Malls struggling the most.

Greater Houston Retail Absorption (12-month Period)

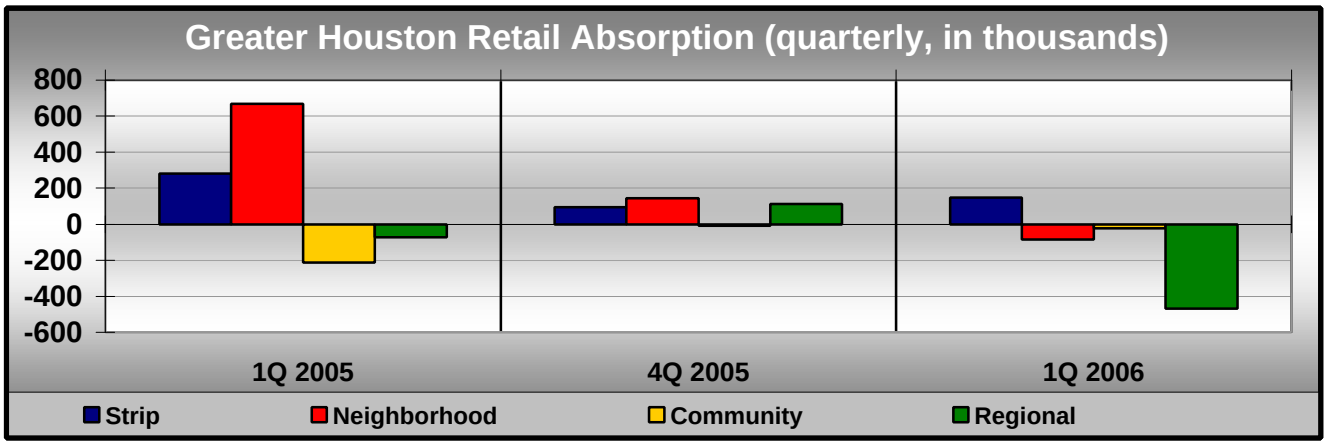
Year Ending	Strip	Neighborhood	Community	Regional	Overall
1Q 2004	828,042	2,357,232	921,022	1,368,852	5,475,148
1Q 2005	812,631	2,222,216	1,225,882	-5,740	4,254,989
1Q 2006	**431,745**	**922,988**	**788,570**	**-615,188**	**1,528,115**

Regional Malls had their softest quarter in several years, posting -469,464 SF of absorption. Annual absorption remains in the red, at -615,188 SF. Much of the negative absorption was due to Mervyn's vacating large spaces in several regional malls, including First Colony Mall in the ***Far Southwest*** sector and The Woodlands Mall in the ***Far North*** sector.

Demand for space in **Community Centers** further weakened, posting its second straight quarter of negative absorption, at -22,088 SF. Annual absorption totals 788,570 SF, despite losses over the last two quarters. The ***Far Southeast*** sector brought down the market with -114,920 SF absorbed.

Neighborhood Centers struggled over the first quarter as well, absorbing -84,260 SF. Annual absorption currently stands at 922,988 SF. The ***Near West*** sector showed strong demand with 33,805 SF absorbed, while the ***Inner Loop*** sector absorbed -65,993 SF.

Strip Centers continued their strong performance, absorbing 146,597 SF over the quarter. This marks the 14th straight quarter of positive absorption for Strip Centers. The ***Far North*** sector was the largest contributor to the gain with 47,696 SF, while the weakest demand was recorded in the ***Near West*** sector with -10,472 SF absorbed.



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OCCUPANCY

Retail occupancy fell substantially over the first quarter, losing 0.61 points and falling below 86% for the first time in two years. Average occupancy, at 85.95%, is at its lowest level in two years. Every market sector posted a decrease in occupancy, with Regional Malls taking the biggest hit, losing more than 2 points.

Greater Houston Retail Occupancy (Quarterly)

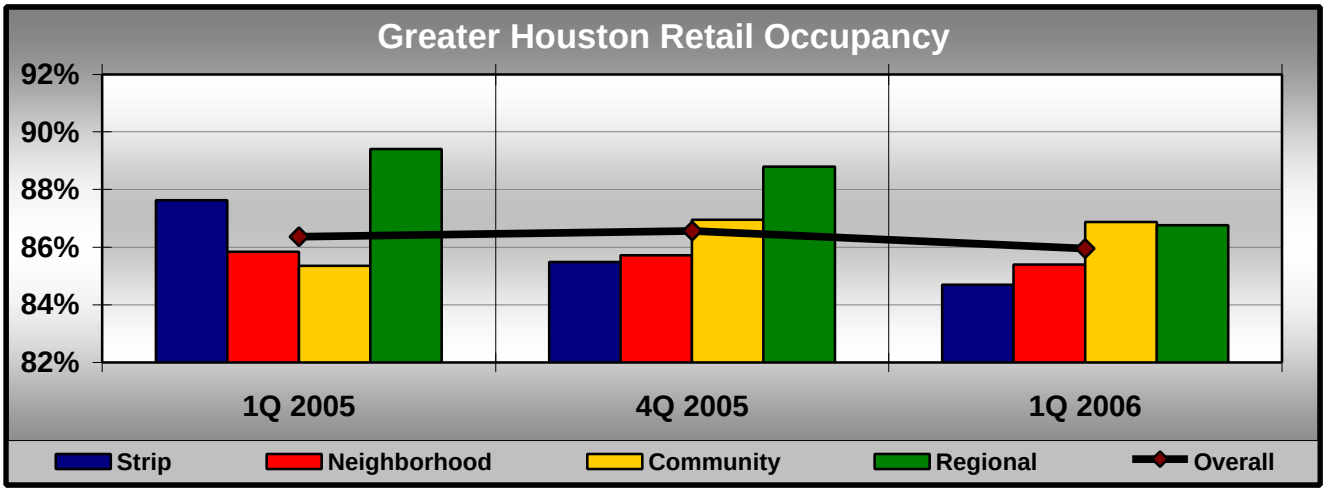
Quarter	Strip	Neighborhood	Community	Regional	Overall
1Q 2005	87.63%	85.84%	85.35%	89.40%	86.36%
4Q 2005	85.48%	85.72%	86.95%	88.79%	86.56%
1Q 2006	**84.70%**	**85.40%**	**86.87%**	**86.76%**	**85.95%**

Regional Mall occupancy plummeted over the quarter, largely due to Mervyn's move-outs in several area malls. Average occupancy lost 2.03 points to reach 86.76%, and now stands 2.64 points below levels at this time last year. The single mall in the ***Far Southwest*** sector, First Colony Mall, suffered a drop in occupancy of nearly 8 points, and now stands at 90.10%.

Community Center occupancy dipped 0.08 points over the quarter to 86.87%, its second straight decrease. However, occupancy has increased 1.52 points since this time last year. The highest occupancy is found in the ***South*** sector at 95.87%, while the lowest is reported by the ***Near North*** sector at 67.78%.

Neighborhood Centers recorded an occupancy decrease of 0.32 points to 85.40% over the last quarter, bringing the total decrease over the year to 0.44 points. None of the 13 sectors reports an occupancy currently above 90%; the ***Far North*** sector has the lowest occupancy at 78.75%.

Occupancy levels at **Strip Centers** continued on a steady decline, decreasing 0.78 points over the quarter to 84.70%. Other than a slight increase in the 1st quarter of 2005, occupancy has decreased every quarter for two years. The ***South*** sector continues to post the highest occupancy, at 93.12%, while the lowest occupancy is found in the ***Far West*** sector, at 77.07%.



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RENTAL RATES

Despite lackluster performance in absorption and occupancy over the last quarter, rental rates continued to increase, posting a $0.01 per square foot (psf) gain. At $1.59 psf, rents are $0.04 higher than levels at this time last year and are at the highest level on record. The highest rents continue to be found in close-in parts of the city, while large amounts of newly constructed centers are driving up rents in some suburban areas.

Greater Houston Retail Rental Rates (Quarterly)

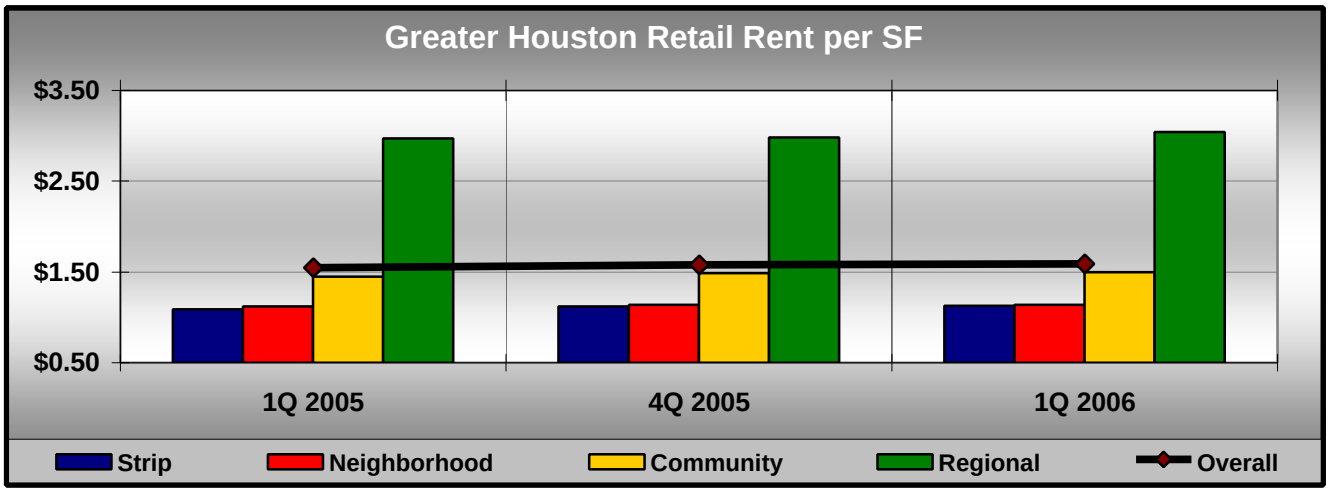
Year	Strip	Neighborhood	Community	Regional	Overall
1Q 2005	$1.09	$1.12	$1.45	$2.97	$1.55
4Q 2005	$1.12	$1.14	$1.49	$2.98	$1.58
1Q 2006	**$1.13**	**$1.14**	**$1.50**	**$3.04**	**$1.59**

Regional Mall rents increased $0.06 over the quarter to $3.04 psf, their highest level since the 3rd quarter of 2004. The ***Near West*** sector, which includes the Galleria and Memorial City Malls, continues to post the highest rents, followed by the ***Far North*** sector, which includes The Woodlands Mall.

Community Center rents posted a modest increase of $0.01 over the quarter to $1.50 psf. The ***Near West*** sector reports the highest average rents at $2.19 psf, while the ***Near Southeast*** and ***Near Northwest*** sectors have the lowest rents at $0.96 psf.

Neighborhood Center rents were unchanged over the quarter, and are up $0.02 over the year to $1.14 psf. The ***Near West*** sector boasts the highest rents at $1.53 psf, followed by the ***Inner Loop*** sector with average rents at $1.50 psf.

Strip Center rents continued their steady upward climb, increasing $0.01 over the quarter to $1.13 psf. Average rents are up $0.04 from this time last year. The ***Inner Loop*** and ***Near West*** sectors report the highest average rents at $1.59 psf, while the lowest rents are found in the ***Near Northwest*** sector at $0.76 psf.



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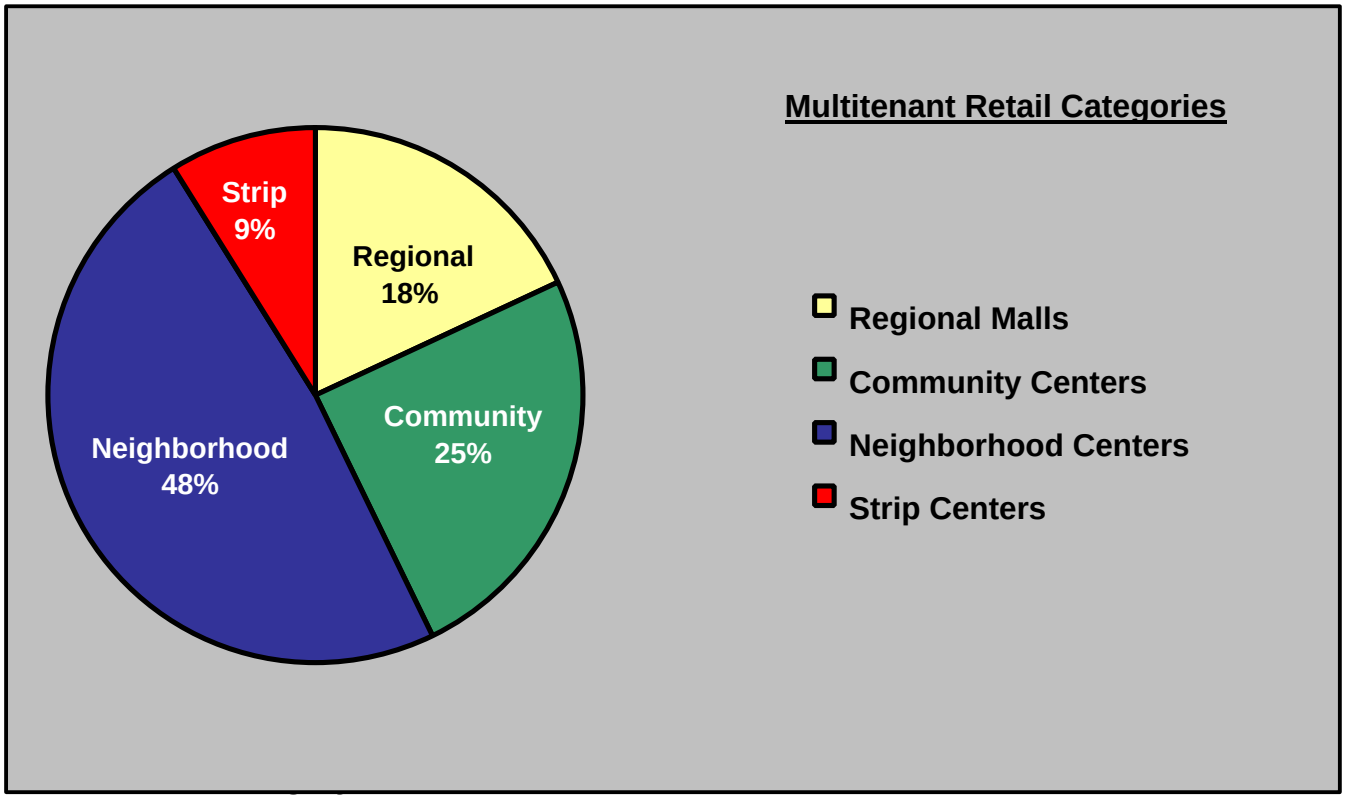
MULTITENANT RETAIL SPACE BY CATEGORY

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	23,880,976
Community Center	139	32,598,849
Neighborhood Center	994	64,275,913
Strip Center	710	11,611,426
Total	**1864**	**132,367,164**



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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