

The Houston Retail Market Update

Edited by Kathryn Koepke

\$399/year

1st Quarter 2007

New Opportunities

For a number of years, much attention in the retail market has focused on the exodus of major retailers from inner cities, and Houston would seem to be the proverbial poster child for such a phenomenon. Few cities can match Houston in terms of sheer sprawl, and with Houston booming these days, new, large-scale retail centers are popping up in far-flung suburbs such as Rosenberg, Conroe, and Tomball. While suburbanites continue to enjoy easy access to retail amenities, many of the retailers located in the new centers have relocated from older parts of town.

However, there are signs that older parts of Houston that seem to be long-forgotten by retailers are, in fact, on the radar of some developers and retailers. One of the most well-known recent examples is the redevelopment of the old **Gulfgate Mall** by **Wulfe & Co.** in 2002. Today the thriving **Gulfgate Center** features a variety of national retailers. It was recently announced that the owners of **Northline Mall** will attempt a similar revitalization; they appear to be off to a good start, as national retailers **Wal-Mart** and **Marshalls** have already signed on.

Other retailers are seeking opportunities in areas where incomes are a bit lower than most retailers prefer and in older centers. Retailers such as **Big Lots** feature clearance and value-priced merchandise, and seek out locations in older centers, frequently occupying vacant former grocery store spaces. These retailers offer merchandise that appeals to consumers in the immediate area, and keep expenses low, often paying very low rental rates. Other retailers have also shifted gears by targeting a specific demographic in some areas; **H-E-B** opened its first **Mi Tienda** location, a store geared toward Hispanic customers, in Pasadena several months ago. The company plans four more such stores in the Houston area. Upscale grocers such as **Central Market** and **Whole Foods** are likewise targeting a specific demographic, the relatively affluent shopper seeking organic and specialty food items.

While there doesn't appear to be a massive shift in retail development from the suburbs to the city on the horizon, the changing character of in-town retail being driven by differentiation of product and target market is likely to continue. Some retailers and developers have begun to recognize the possibilities and the potential is there for more retailers to capitalize on these long-ignored in-town markets.

By: [Chris Law](#)

Houston Retail Market at a Glance

	Strip	Neigh.	Comm.	Regional	Overall	Qtr	Yr
Occupancy	84.14%	84.75%	87.14%	87.75%	85.81%	▲	▲
Rent/SF	\$1.16	\$1.17	\$1.58	\$3.00	\$1.60	▲	■
Absorption	101,512	129,968	293,640	181,572	706,692	▲	▲

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Metro Occupancy Overview

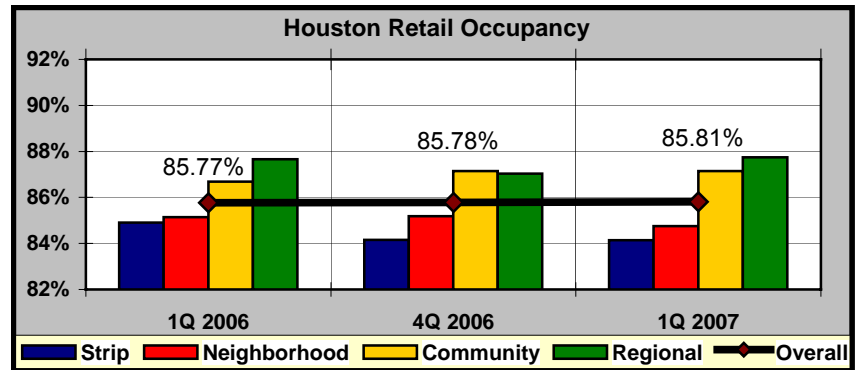
A third straight quarter of occupancy gains pushed retail occupancy above levels this time last year to 85.81%. Occupancy gained 0.03 points over the quarter and has increased 0.04 points over the past four quarters.

Regional Malls was the only retail category to post an increase in occupancy over the quarter, gaining 0.72 points to 87.75%. Occupancy has increased 0.09 points since this time last year. The highest occupancy was found in the **Near Southeast** sector at 94.03%, while the **Near Northwest** sector once again reported the lowest occupancy at 74.41%.

Community Center occupancy was unchanged over the quarter at 87.14%. However, occupancy is up 0.45 points over the year. The **South** sector continues to report the highest occupancy, at 98.47%, while the **Near Southeast** sector recorded the lowest occupancy at 74.09%.

Neighborhood Centers posted the largest decline over the quarter, slipping 0.44 points to 84.75%. Occupancy is now 0.40 points below its level 12 months ago. The **South** sector again recorded the highest occupancy, at 93.14%, while the lowest occupancy was found in the **Far North** sector at 79.94%.

Occupancy at **Strip Centers** declined for the second straight quarter, decreasing 0.01 point to 84.14%; occupancy has fallen 0.77 points since this time last year. The **Near Southwest** sector reported the highest occupancy at 91.21%, while occupancy was weakest in the **Near West** sector at 77.88%.



Quarter	Strip	Neighborhood	Community	Regional	Overall
1Q 2006	84.91%	85.15%	86.69%	87.66%	85.77%
4Q 2006	84.15%	85.19%	87.14%	87.03%	85.78%
1Q 2007	84.14%	84.75%	87.14%	87.75%	85.81%

Metro Rent Overview

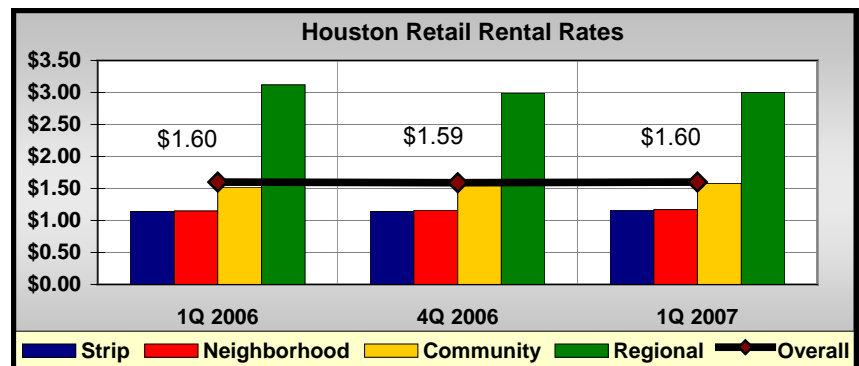
Overall rents increased for the third straight quarter, gaining \$0.01 per square foot (psf) over the quarter to \$1.60 psf. Rental rates are unchanged from one year ago. All four categories of retail centers posted an increase in rental rates over the first quarter.

Regional Mall rents increased \$0.01 psf over the quarter. However, currently at \$3.00 psf, rental rates remain \$0.12 psf below levels this time last year. The **Near West** sector recorded the highest rents at \$4.86 psf, followed by the **Far North** sector at \$3.78 psf, while the lowest rents are found in the **Near Northwest** sector at \$1.54 psf.

Community Center rents posted another solid increase, rising \$0.03 psf over the quarter to \$1.58 psf. Community Center rents have gained \$0.06 psf over the last 12 months. The highest rents were found in the **Near West** sector at \$2.18 psf, while the **Near Northwest** sector reported the lowest rents at \$0.88 psf.

Neighborhood Center rents posted a second consecutive increase, gaining \$0.01 psf to \$1.17 psf; neighborhood center rents are now \$0.02 psf higher than one year ago. The **Near West** sector continues to post the highest rental rates at \$1.63 psf, while the lowest rents were found in the **Near Southeast** sector at \$0.94 psf.

Strip Center rents increased for the first time in four quarters, increasing \$0.02 psf to \$1.16 psf. Rents are \$0.02 psf higher than one year ago. The **Inner Loop** sector reports the highest rents at \$1.64 psf, while the **Near Northwest** sector has the lowest rents at \$0.80 psf.

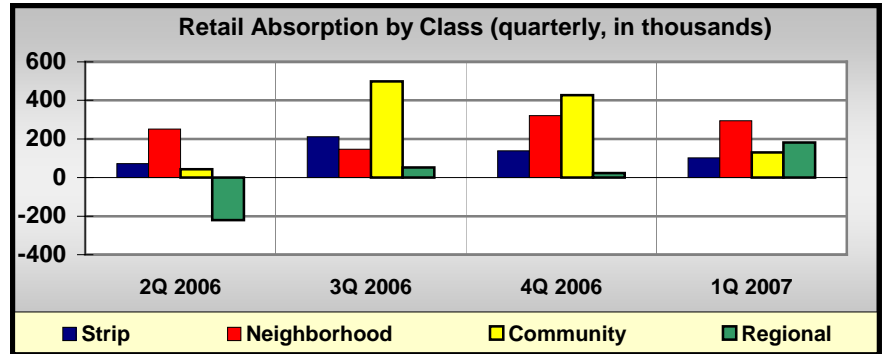


Quarter	Strip	Neighborhood	Community	Regional	Overall
1Q 2006	\$1.14	\$1.15	\$1.52	\$3.12	\$1.60
4Q 2006	\$1.14	\$1.16	\$1.55	\$2.99	\$1.59
1Q 2007	\$1.16	\$1.17	\$1.58	\$3.00	\$1.60

Metro Absorption Overview

Retail demand was strong once again, as the market posted quarterly absorption of 706,692 SF. Absorption figures were strong in every category, as every sector had absorption of over 100,000 SF, with neighborhood centers posting the strongest figures. Year-over-year absorption currently stands at 2,671,364 SF.

Regional Malls posted their strongest absorption figures in nearly 3 years, absorbing 181,572 SF over the quarter and bringing annual absorption into the black at 36,412 SF. The **Northeast** sector led the way, absorbing 282,056 SF over the quarter, while the **Near Southwest** sector reported the weakest demand, absorbing -142,319 SF.



12-mo Ending	Strip	Neighborhood	Community	Regional	Overall
1Q 2005	813,326	2,302,724	1,313,852	62,260	4,492,162
1Q 2006	482,601	888,152	869,862	-615,188	1,625,427
1Q 2007	524,690	1,011,944	1,098,318	36,412	2,671,364

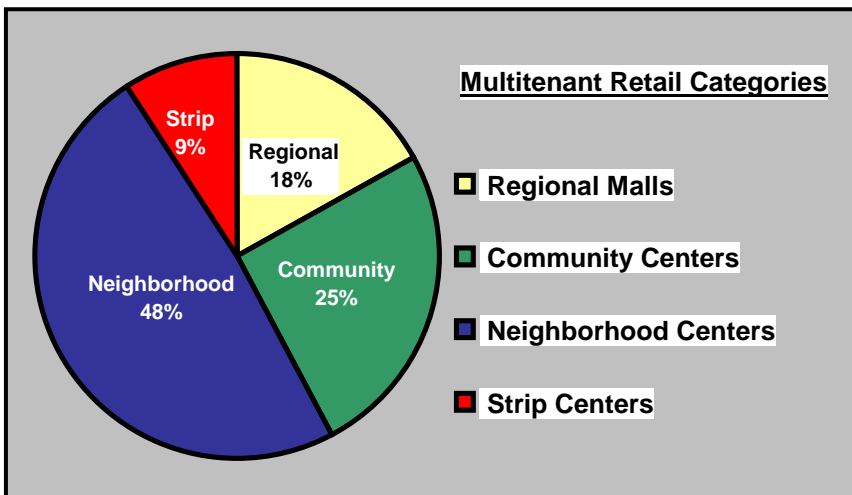
Community Centers recorded a fourth straight quarter of positive absorption, absorbing 129,968 SF. The sector has the highest absorption of any category over the past 12 months, at 1,098,318 SF. The Far West sector recorded the strongest quarterly absorption, with 164,064 SF absorbed, while the weakest was recorded in the **Northeast** sector with -58,054 SF.

Neighborhood Centers posted the strongest absorption over the quarter, with 293,640 SF absorbed. Absorption in neighborhood centers since this time last year is 1,011,944 SF. The **Far Northwest** and **Northeast** sectors posted the strongest absorption, at 147,994 SF and 107,704 SF, respectively. The weakest demand was found in the **Near Southeast** sector, which posted absorption of -119,175 SF.

Strip Centers posted absorption of 101,512 SF over the first quarter, bringing year-over-year absorption to 524,690 SF. The **Near Northwest** sector posted the strongest absorption with 42,700 SF absorbed, while the weakest absorption was found in the **Far Southwest** sector with -19,775 SF absorbed.

Retail Inventory

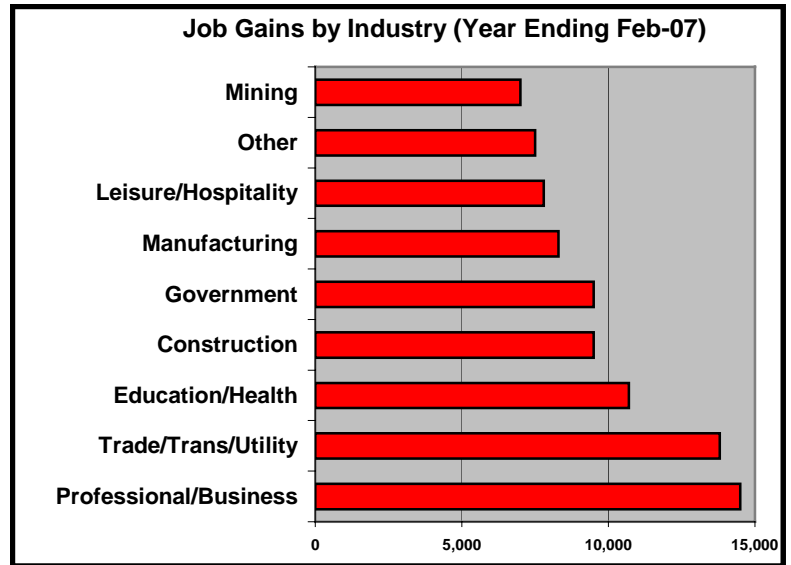
O'Connor & Associates divides multitenant retail space into four basic categories for purposes of analysis: Regional Malls, Community Centers, Neighborhood Centers, and Strip Centers. Based on the number of retail centers and square footage, Neighborhood Centers lead other categories with 48% of the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



Type	# of Centers	NRSF
Regional Mall	20	23,031,008
Community	145	33,912,609
Neighborhood	1,022	65,882,347
Strip	759	12,405,259
TOTAL	1,946	135,231,223

Job Growth

The civilian labor force unemployment rate in the ten-county Houston MSA was flat at 4.6%, while the total number of nonagricultural wage and salary jobs increased to 2,484,700 in February 2007, according to the **Texas Workforce Commission**. This month's total is 15,600 jobs more than at this time last year. Of the nonagricultural employers, Professional & Business Services gained 14,500 jobs over the previous 12 months; Trade, Transportation, & Utilities gained 13,800 jobs; Education & Health Services is up 10,700 jobs; Construction added 9,500 jobs; Government added 9,500 jobs; Manufacturing added 8,300 jobs; Leisure & Hospitality gained 7,800 jobs; Other Services gained 7,500 jobs; and Mining added 7,000 jobs. The only industry to lose jobs over the year was the Information sector with -400 jobs. The largest monthly gain was in the Government sector with 6,500 jobs.

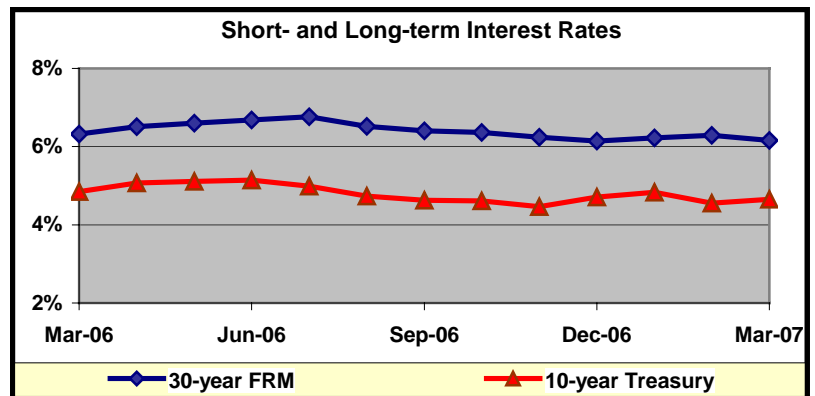


Interest Rates

The yield on the **10-year Treasury** note rose to 4.67% in April 2007, down 0.40 points from its 5.07% yield one year ago.

The **30-year fixed-rate mortgage (FRM)** averaged 6.16% in March 2007. One year ago, the 30-year FRM was at 6.32%. The average for the **15-year FRM** in March was 5.88%, down 0.09 points from a year ago.

The **Prime Rate** in April was reported in the Wall Street Journal at 8.25%, up 0.50 points from a year ago.



Key Indicators

The latest **Conference Board Survey** indicates that the **Consumer Confidence Index** decreased to 107.2 in March 2007, down 4.0 points from 111.2, in February. The index is an indicator of consumers' overall assessment of current conditions, relative to a figure of 100 in 1985, the base year. The **Index of Leading Economic Indicators** decreased 0.5% in February to 137.3. The index is an indicator of direction the economy is expected to take in coming months, relative to a figure of 100 in 1996, the base year.

Advance estimates reported by the **U.S. Department of Commerce** show that seasonally adjusted national retail and food services sales for February 2007 were \$370.5 billion, an increase of 0.1% from January, and up 3.2% from February 2006. Retail trade sales were up 0.2% from January, and were 3.1% above last year's level.

The **U.S. Department of Commerce** reports that real GDP, the output of goods and services produced by labor and property in the United States, increased at an annual rate of 2.5% in the fourth quarter of 2006, up from the 2.0% growth rate recorded in the third quarter of 2006. The increase in GDP during the fourth quarter was attributed to positive contributions from personal consumption expenditures, exports, state and local government spending, and federal government spending.

Data Collection

Our in-house research team continuously updates data for over 2,500 retail centers in our database. We update these properties on a quarterly basis to generate accurate market trend reports on rents, occupancy, absorption, etc. Our quarterly surveys also update other property-specific data such as rent types, largest contiguous space available, leasing and management information, and owner information. We perform current and historical data audit after we close each month's survey to identify any data inconsistencies or incorrectly keyed values.

Research

We monitor various news media, press releases, marketing materials, web-sites, CAD records, permit issuance, and other sources to capture new construction, planned projects, financing, and sales. Our researchers conduct phone interviews with relevant developers, brokers, or lenders to gather information on new construction and sales. We add properties to our database on a regular basis to ensure we offer the most up-to-date and complete retail database.

Market Coverage

Our retail database covers the Greater Houston market and includes properties in Harris, Galveston, Brazoria, Fort Bend, and Montgomery counties. The market is divided into 13 submarkets that correspond to different sectors of the greater Houston area. This approach allows the user to view distinct areas of town in which properties can be identified together.

Glossary

Absorption = Change in occupied square feet, including new construction. Absorption is a proxy for demand.

Occupancy = Percentage of physically occupied square feet on property.

Rents = Market rents.

Type = Multi-tenant properties are classified as Regional Malls, Community Centers, Neighborhood Centers, or Strip Centers based on size. Strip Centers are properties that have between 10,000 and 24,999 net rentable square feet. Neighborhood Centers are properties that have between 25,000 and 149,999 net rentable square feet. Community Centers are properties that have between 150,000 and 599,999 net rentable square feet. Regional Malls are properties that have 600,000 net rentable square feet or more. Single-tenant centers are not classified.

Reporting

Occupancy, Rent, and Absorption trend data is based on Operating and Multi-Tenant Regional Malls, Community Centers, Neighborhood Centers, and Strip Centers. Single-tenant properties are excluded from the data.



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